Canadian–American Free Trade: Historical, Political and Economic Dimensions

Conference Papers

Edited by
**A.R. Riggs
and Tom Velk**
North American Studies
McGill University

The Institute for Research on Public Policy
L'Institut de recherches politiques

87-06118/

The Institute for Research on Public Policy
L'Institut de recherches politiques

A national, independent, research organization
Un organisme de recherche national et indépendant

Founded in 1972, The Institute for Research on Public Policy is a national organization whose independence and autonomy are ensured by the revenues of an endowment fund which is supported by the federal and provincial governments and by the private sector. In addition, the Institute receives grants and contracts from governments, corporations and foundations to carry out specific research projects.

The *raison d'être* of the Institute is threefold:

- To act as a catalyst within the national community by helping to facilitate informed public debate on issues of major public interest
- To stimulate participation by all segments of the national community in the process that leads to public policy making
- To find practical solutions to important public policy problems, thus aiding in the development of sound public policies.

The Institute is governed by a Board of Directors, which is the decision-making body, and a Council of Trustees, which advises the Board on matters related to the research direction of the Institute. Day-to-day administration of the Institute's policies, programs and staff is the responsibility of the president.

The Institute operates in a decentralized way, employing researchers located across Canada. This ensures that research undertaken will include contributions from all regions of the country.

Wherever possible, the Institute will try to promote public understanding of, and discussion on, issues of national importance, with clarity and impartiality. Conclusions or recommendations in the Institute's publications are solely those of the author and should not be attributed to the Board of Directors, Council of Trustees, or contributors to the Institute.

The president bears final responsibility for the decision to publish a manuscript under the Institute's imprint. In reaching this decision, he is advised on the accuracy and objectivity of a manuscript by both Institute staff and outside reviewers. Publication of a manuscript signifies that it is deemed to be a competent treatment of a subject worthy of public consideration.

Publications of the Institute are published in the language of the author, along with an executive summary in both of Canada's official languages.

Canadian-American Free Trade: Historical, Political and Economic Dimensions

Canadian-American Free Trade: Historical, Political and Economic Dimensions

Edited by
A.R. Riggs and Tom Velk
North American Studies
McGill University

The Institute for Research on Public Policy /
L'Institut de recherches politiques

Copyright © The Institute for Research on Public Policy 1987
All rights reserved

Printed in Canada

Legal Deposit Third Quarter
Bibliothèque nationale du Québec

Canadian Cataloguing in Publication Data

Main entry under title:
Canadian-American free trade

Proceedings of a conference organized by the North American Studies Program, McGill University and held in Montreal, Mar. 18-19, 1987.

Foreword in English and French.
ISBN 0-88645-055-1

1. Canada – Commercial policy. 2. United States – Commercial policy. 3. Tariff – Canada. 4. Tariff – United States. 5. Free trade and protection – Free trade. I. Riggs, A.R. (Alvin Richard), 1931- II. Velk, Tom, 1938- III. McGill University. North American Studies Program IV. Institute for Research on Public Policy V. Title.

HF1763.C35 1987 382'.0971'073 C87-090251-2

The camera-ready copy for this publication was created on a Xerox 6085 Desktop Publishing System.

The Institute for Research on Public Policy/
L'Institut de recherches politiques
P.O. Box 3670 South
Halifax, Nova Scotia B3J 3K6

Contents

North American Studies, McGill University ix

Foreword xi

Avant-propos xiii

Biographical Sketches of Authors xv

Acknowledgements xvii

I. Introduction 1

McGill's Wilkenson Lectures and the Current Free-Trade Negotiations 3
Tom Velk and A.R. Riggs

II. Historical Roots of North American Free Trade 7

Reciprocity 1911: The Canadian Perspective 9
Paul Stevens

Reciprocity 1911: Through American Eyes 23
Tom Velk and A.R. Riggs

Trends in Canada-U.S. Free-Trade Discussions: 1911-1986 33
Earl H. Fry

Canada's Foreign Policy in Search of a Fourth Option: Continuity and Change in Orientation Towards the United States 45
P. Soldatos

III. Economics and Free Trade: The Pros and Cons 65

Canada's Trade Options 67
Richard G. Lipsey

The Free-Trade Initiative: On Course or Off? 75
Irving Brecher

"Truck and Trade with the Yankees": The Case for a Canada-United States Comprehensive Trade Agreement 85
Thomas d'Aquino

Looking Outward Again 97
André Raynauld

The Received Wisdom of Canada-U.S. Free Trade: Qualifications 105
Randall Wigle

Canada-United States Free Trade: Economic Realities and Political Choices 115
Robert A. Young

What Do Economists Know About Free Trade? 141
Tim Hazledine

IV. Special Issues: Technical, Political and Social Dimensions of Free Trade 159

Bankruptcy Law, Free Trade, and Economic Adjustments: Preliminary Considerations 161
Benoît-M. Papillon

Financial and Economic Dimensions of Free Trade 177
E.P. Neufeld

Canada-U.S. Free Trade and Canadian Culture 185
Donald Armstrong

CUFTA and Canadian Independence 195
Peyton V. Lyon

Removing Barriers to Canada-United States Trade 199
Frank Stone

Parizeau on Trade 213

V. Distinguished Conference Speakers 219

Address 221
The Honourable Thomas M.T. Niles,
United States Ambassador to Canada

Why Canada Needs Free Trade 229
The Honourable Robert Layton,
Member of Parliament

The U.S.-Canadian Free Trade Negotiations:
Historic Opportunity 237
Louis F. Laun, United States Assistant
Secretary of Commerce for International Policy

Address: The Tale of Two Countries 245
Hugh MacLennan, Novelist

Members of the Institute 253

Institute Management 257

Publications Available 259

North American Studies, McGill University

North American Studies at McGill was founded in 1968 "to give undergraduates a fairly comprehensive view of the growth and achievements of North American Civilization." The strongest and most stable program of its kind in the university in terms of enrollment, it continues to make use of existing courses to provide students with a broad, liberal education that includes history, Canadian and American literature, politics and economics. All majors in the program are required to take a capstone seminar, which has been offered each year since the studies were instituted.

During the last decade North American Studies has added innovative new dimensions to its offerings. Exchange agreements for both teachers and students have been negotiated with Dartmouth College, Duke University, Georgetown, American University and Carleton (Ottawa). The government internship program that American University offers in Washington, D.C. has been especially popular with undergraduates.

With the help of a generous gift from a friend of the university, annual symposia were established to bring in dozens of scholars of international reputation. Known today as the Wilkenson Lectures, they have dealt with such topics as Liberty, Equality and Authority (1983); The Liberal Tradition in America Revisited (1984); Mark Twain (1986); and Canadian-American Free Trade (1987), the most elaborate so far.

North American Studies is operated by a Director, but policy and decision-making are the responsibility of the North American Studies Committee, a multi-departmental group under the Faculty of Arts.

Foreword

Negotiations for a comprehensive Canada-United States trade agreement have been underway since the spring of 1986 and are expected to be concluded in the autumn of 1987, at which time the proposed text is to be submitted for ratification in the legislatures of both countries. These negotiations are aimed at sweeping away remaining barriers to cross-border trade in goods and services, and at putting in place new rules for this trade that would better accommodate the large, close and intricate trade and economic relationships between the two countries. A successful outcome to these negotiations would be of historic importance, building a free trade arrangement upon the impressive process of bilateral trade liberalization that has already been achieved over the past half century.

The consequences for the future development of Canadian social and political structures may also be dramatic, serving not only to integrate the North American economies more fully, but also to bind Canadian political and regulatory decisions more tightly into American mechanisms, reflecting American values. While one might hope that mutual acceptance of agreed rules and dispute resolution mechanisms would offer greater insulation from American political pressures, and hence greater scope for independent economic and social policy in Canada, experience to date with examples like softwood lumber or natural gas pricing suggests that the price of more assured access to U.S. markets for Canadian exports of manufactured goods may well be the extraterritorial application of American standards and criteria in the appraisal of Canadian economic, cultural, or social policy. The determination whether, on balance, this further economic integration might prove to be in the broad national interest is therefore complex indeed, and the choice facing Canadians in the fall may be a tough one.

A conference organized in Montreal in March 1987 by the North American Studies Program at McGill University was therefore very timely, and made a valuable contribution to understanding the issues involved in the negotiations. This volume contains the proceedings of that conference, and whatever the outcome of the negotiations, the papers presented at the conference and the introduction by the editors will be of permanent value in illuminating the importance and complexity of the Canada-United States relationship.

The Institute for Research on Public Policy is pleased to publish these proceedings of the Montreal conference as a further contribution to the understanding and public debate of policy issues of vital concern to Canadians.

Rod Dobell
President
Institute for Research on Public Policy

Avant-propos

Des négociations ayant trait à un accord commercial global entre le Canada et les États-Unis sont en cours depuis le printemps 1986, et l'on s'attend à ce qu'elles aboutissent en automne 1987, après quoi le texte proposé devra être soumis au corps législatif des deux pays en vue de sa ratification. Ces négociations visent à éliminer les derniers obstacles au commerce des biens et services et à mettre en place de nouveaux règlements régissant ce commerce dans le but d'améliorer les relations commerciales et économiques étroites, complexes et de grande envergure entre ces deux pays. Un succès résultant de ces négociations aurait une valeur historique, car il mènerait à un accord de libre échange rendu possible par la libéralisation impressionnante du commerce bilatéral déjà réalisée lors des cinquante dernières années.

Il se peut aussi que les conséquences pour le développement futur des structures canadiennes politiques et sociales soient considérables, servant non seulement à intégrer encore plus les économies nord-américaines, mais aussi à lier encore plus les décisions politiques et régulatrices prises au Canada aux mécanismes américains qui reflètent des valeurs américaines. Bien que l'on puisse espérer que l'acceptation mutuelle de règles et de mécanismes permettant le règlement de conflits nous mette plus à l'abri des pressions politiques américaines, permettant ainsi une meilleure perspective pour une politique économique et sociale indépendante au Canada, à l'heure actuelle, certaines expériences, telles que les questions concernant le bois d'œuvre où la fixation du prix du gaz naturel suggèrent qu'un accès plus sûr de l'exportation canadienne de produits manufacturés aux marchés américains s'achètera peut-être au prix de l'application de normes et critères américains à l'évaluation des politiques économiques, culturelles ou sociales canadiennes. Il est donc bien difficile de déterminer si cette nouvelle intégration économique s'avèrera être dans l'intérêt national. En effet, le problème est complexe, et la décision que les Canadiens devront prendre en automne pourra être difficile.

La conférence organisée à Montréal en mars 1987, à l'Université McGill par le Programme d'études nord-américaines a donc été très à propos et a contribué de façon importante à comprendre les questions impliquées dans les négociations. Ce volume contient les actes de cette conférence. Quels que soient les résultats des négociations, les communications présentées à la conférence ainsi que l'introduction des éditeurs seront toujours valables, car elles soulignent l'importance et la complexité des relations entre le Canada et les États-Unis.

L'Institut de recherches politiques a l'honneur de publier les actes de la conférence de Montréal dans le but de permettre aux Canadiens une meilleure compréhension des problèmes politiques les plus importants et d'un stimuler un débat public.

Rod Dobell
président
Institut de recherches politiques

Bibliographical Sketches of Authors

Thomas d'Aquino of Ottawa is President and Chief Executive Officer of the Business Council on National Issues, comprising the chief executive officers of 150 leading Canadian corporations.

Donald Armstrong is Professor at McGill University in the Faculty of Management, which he founded under its earlier title, The Graduate School of Business.

Irving Brecher is Professor Emeritus and Past Chairman of the Department of Economics, McGill University.

Earl H. Fry is Professor of Political Science and Chairman of Canadian Studies at Brigham Young University.

Tim Hazledine is Associate Professor in the Department of Agricultural Economics at the University of British Columbia.

Peyton Lyon is Professor of Political Science at Carleton University, Ottawa.

Richard Lipsey is Sir Edward Peacock Professor of Economics, Queens University, and Senior Economic Advisor, C.D. Howe Institute, Toronto.

E.P. Neufeld of Toronto is Executive Vice-President for Economics and Government Affairs, The Royal Bank of Canada, and a Member of the Board of Directors of the C.D. Howe Institute.

Benoit-M. Papillon is an Economist with the Economic Council of Canada, Ottawa.

Jacques Parizeau, former Minister of Finance, Province of Quebec, is Professor of Economics at the Institut d'économie Appliquée, Hautes Études Commerciales, and Member of the Board of Governors of the Université de Montréal.

André Raynauld is Professor of Economics, Université de Montréal, and a former president of the Canadian Economics Association.

A.R. Riggs is Associate Professor, Department of History, McGill University, and Co-Director of North American Studies.

P. Soldatos is Professor of Political Science, Université de Montréal.

Paul Stevens is Associate Professor of History, York University.

Frank Stone is Director of the International Economics Program of the Institute for Research on Public Policy.

Tom Velk is Associate Professor of Economics, McGill University, and Co-Director of North American Studies.

Randall Wigle is Assistant Professor of Economics at the University of Western Ontario.

Robert Young is Associate Professor of Political Science at the University of Western Ontario.

Acknowledgements

This volume, published by the Institute for Research on Public Policy, contains the proceedings of an international conference in Montreal on March 18-19, 1987, organized by the North American Studies Program at McGill University. The conference was a further addition to the annual Wilkenson Lectures series at McGill, which is sponsored by the North American Studies Program with much appreciated financial assistance provided by Mrs. George Packer Berry of Princeton, New Jersey. Additional funding for the conference provided by ALCAN and The Bank of Montreal is gratefully acknowledged, as is support for the publication of the proceedings of the Department of External Affairs.

We wish also to thank McGill Principal David Johnston, Dean of Arts Richard Salisbury and Vice-Principal Paul Davenport, for their invaluable assistance and support in the organization of the conference. Those who contributed by chairing sessions deserve our gratitude as well: Jagdish Handa and Suzanne Levesque, Department of Economics, McGill; Hal Waller, Political Science; Stephen J. Randall, History; Pierre-Paul Proulx, Economics, Université de Montréal; and Senator Carl Goldenberg, Q.C. The Writers Development Trust graciously allowed us to publish an edited version of Hugh MacLennan's Margaret Laurence Memorial Lecture.

Our appreciation for their cooperation in publishing these proceedings is extended to Rod Dobell, President of the Institute for Research on Public Policy; to Frank Stone, Director of the Institute's International Economics Program; and to Parker Staples and Ruby

Day of the Institute's office in Halifax who were responsible for the production of this volume.

I
Introduction

McGill's Wilkenson Lectures and the Current Free-Trade Negotiations

Tom Velk and A.R. Riggs

The summer of 1987 may be remembered in Canada as one of the most significant in the history of the country. A constitutional accord and free trade with the United States, both unfinished business for well over a century, dominated the headlines, and if both get accepted it would be hard to predict which one will have a more lasting or telling impact on life above the 45th parallel.

Canada and the United States had free trade for a short period in the nineteenth century. They almost renewed the marriage of convenience on Canada's initiative in 1911, but backed off at the last moment. Other initiatives on a less comprehensive scale were attempted in the 1930s and 1940s, and since then trade has expanded and become freer over many sectors. If negotiations between American representative Peter Murphy and Canada's Simon Reisman are successful, the two nations could renew their nineteenth century arrangement in 1987.

The two-day conference that convened at McGill University on March 18, 1987, was fortuitously scheduled on the heels of a preliminary, but historic debate in the Canadian Parliament, the first such on the issue of free trade for 75 years. It came just as flagging interest on the part of the Canadian public dramatically revived because of ominous rumbles of protectionism in a Democratically controlled Congress to the south. The people who assembled at McGill to consider the question, academics and others whose thoughts appear in this volume, were hand-picked for the job because they had proved in the past that they have something worthwhile to say on the subject.

The results appear under four headings that follow this introduction. Whatever their personal feelings about protectionism and free trade, it hardly seems necessary to point out that on a subject that could use less posturing and more sober deliberation, they are well-qualified to speak their minds. Some, such as international lawyer and head of Canada's Business Council on National Issues, Thomas d'Aquino, and E.P. Neufeld of the Royal Bank of Canada, have an enormous stake in the outcome of trade talks because of the nature of their professions. Several on our list, Irving Brecher, André Raynauld, and Peyton Lyon, for example, were writing about or advocating free trade with the United States long before some others were old enough to know or care about the difference between tariff-protected and duty-free goods. They were in on the founding of the present movement.

Some of our essayists, like Richard Lipsey, perhaps the most prolific professional economist in Canada, are enthusiastic advocates of free trade. Others – younger scholars whose essays are also included in the Table of Contents under Part III, "Pros and Cons" – for example, Robert Young, Tim Hazledine and Randall Wigle, have serious reservations about the benefits of free trade for the people of Canada.

That is as it ought to be. Economics and politics involve human behaviour that often confounds those who would make careful predictions. There is even controversy among economists about how much disagreement exists among them concerning free trade. Information is the only commodity that will help them or the public at large to make up its mind. Since the impact of free trade would have to be far greater on Canada than on the United States, the smaller country may be forgiven if it appears to hesitate or waffle.

A widespread ignorance regarding the issues of free trade is precisely why we chose to open our conference proceedings, and this volume, Part II, with several essays that provide historical background: Paul Stevens on the Canadian debate over reciprocity in 1911; Tom Velk and A.R. Riggs on American attitudes that year; Earl Fry – whose business at Brigham Young is to make sense of Canadian culture – with an overview of the period 1911-1986; and P. Soldatos on free trade within the broader context of Canadian foreign policy options.

Certain of our participants deal with issues of a technical nature. Their essays we have categorized, under Part IV, as "Special Issues". Benoît-M. Papillon of the Economic Council of Canada considers bankruptcy law and free trade; Jacques Parizeau speculates about free trade; Donald Armstrong, from McGill's Faculty of Management, examines the often-repeated shibboleth that free trade will either harm or eliminate Canadian culture; and Frank Stone, a Research

Director with The Institute for Research on Public Policy, provides a succinct and much-needed analysis of what barriers, tariffs and otherwise, would be scheduled for demolition under a free trade agreement.

Distinguished speakers stimulated debate at the conference, and their remarks have been included under Part V. Thomas Niles, American Ambassador to Canada, provides us with an official view from Washington, while Robert Layton, Member of Parliament for Lachine, Quebec, illuminates the Canadian government's position. Louis Laun, American Assistant Secretary of Commerce, views free trade negotiations as an historic opportunity to change misguided and long-congealed attitudes on both sides of the border. Hugh MacLennan has the last word as he talks about the solitudes that can exist between neighbouring countries.

The final outcome of the age-old North American free trade debate is not yet clear. But it is deeply satisfying to know that McGill University's North American Studies Program and The Institute for Research on Public Policy can play a small part in the process of conveying information to a public that will desperately need it in order to make up its mind about free trade. The conference, and this volume, will have fulfilled their intended function if they provide a better understanding of what might be the most important cross-border agreement of the century.

II

Historical Roots of North American Free Trade

Reciprocity 1911: The Canadian Perspective

Paul Stevens

No issue was more prominent in the politics of the last two decades of the nineteenth century and the first few years of the twentieth than the protective tariff. Between 1878, when John A. Macdonald proclaimed his "National Policy" of tariff protection, and 1911, the so-called free trade election in Canadian politics, it was the central issue in Canadian politics. In 1878, 1882, 1887 and 1891, Macdonald parlayed the National Policy into one election triumph after another. The Liberals, in turn, once they had ended their flirtation with unrestricted reciprocity in 1893 and had adopted a policy strikingly similar to that of Macdonald and the Conservatives, were ready to mount successful campaigns in 1896, 1900, 1904 and 1908. "It is not impossible that the tariff issue was invested with exaggerated importance," wrote one political observer in 1903, "and that other questions of equal concern to the people and less inimical to the stability of business conditions were overlooked." The fact of the matter was, however, "it was the warp and woof of our political literature."[1]

The irony was that despite the political appeal of the National Policy, ever since the abrogation of Reciprocity Treaty of 1854, political leaders, both Conservative and Liberal, had looked longingly to the United States for some new form of reciprocity arrangement. Although the Americans had rebuffed Macdonald's overtures in 1869 and 1871, and the draft Brown-Fish Treaty had died in the American Senate four years later, the idea of reciprocity was never far from the surface of Canadian politics. While Macdonald brandished the club of the protective tariff, successive Conservative budgets revealed that he remained ready to negotiate with the Americans should the latter be willing. Even the 1891 election campaign, where Macdonald wrapped himself in the flag with the ringing declaration "A British subject I was born, a British subject I will die" to defeat the Liberals and unrestricted reciprocity, was not nearly as clear cut as the historians would have it. What Macdonald in fact argued was that the Americans were not willing to negotiate a fair reciprocity treaty with Canada, and that the Liberals would sell the country out to bring one about. Laurier, too, made his pilgrimage to Washington in 1897, one year after he had become prime minister, and when the Americans again turned a deaf ear to his proposals, he made it abundantly clear that while he would not be coming to the American capital again, he was willing to negotiate a large measure of free trade between Canada and the United States should the Americans "come and knock at our door."[2] As late as 1911, even the Conservative caucus was overwhelmed when it learned the details of the Taft-Fielding Agreement, and the Conservative leader, Robert Borden, sadly reported to his diary that it would undoubtedly assure the Liberals power for another term or more.[3]

The story, of course, takes an abrupt turn at this point. The Conservatives pulled themselves together – or were pulled together by others – and successfully opposed reciprocity in the general election of 1911. It is a story which has been told on a number of occasions. In most versions we are told, the government adopted reciprocity in response to the demands of farmers in Western Canada who met with Laurier in the summer of 1910 when the Liberal prime minister toured the Canadian west, then marched on Ottawa in the thousands at the end of the year. The agreement which followed, it is usually argued, contained a number of advantages for Canadians in general, and for the farmers in particular. But it was rejected at the polls because the majority of "Canadians reluctantly came to the conclusion that reciprocity was a threat to the preservation of Canadian nationality and the British connection.

The story, however, is somewhat more complex. Scholars, recently, have devoted considerable time to an analysis of the election campaign and the reasons for the result.[4] The question, however, which they have largely ignored is why the Laurier government committed itself to reciprocity in the first place. Laurier, after all, was a practical politician. He could not have been prime minister for almost 15 years had he not possessed an acute sense of the political pitfalls of an issue like reciprocity, an issue which was as old as the Dominion itself. That the farmers in Western Canada were clamouring for tariff reductions was certainly clear, and historians, for the most part, have attributed reciprocity to the success of their campaign.[5] Such an interpretation, however, overlooks a number of factors. Laurier, himself, was distinctly unimpressed with the problems of the farmers he encountered, as his correspondence reveals. Reciprocity, in any case, was only one of a whole range of economic and social issues which they raised, and it could well be argued that Laurier might have selected any number of those issues, issues which would obviously have been politically less explosive, if his primary concern had been to placate the west. Moreover, while his meetings with the farmers revealed support for reciprocity, he was also aware that there was also considerable opposition to the proposition, particularly in Ontario. Laurier could count, and there were many more seats to be lost in Ontario than to be gained in the west.[6] The question, therefore, remains: why risk the political dangers of an issue like reciprocity which had proved in the past to be the political graveyard of those who had espoused it?

Laurier was the first of our continentalist prime ministers. By this I mean, he was the first of our prime ministers to appreciate how much the fact we shared the North American continent with the United States would shape our national destiny. "I am a great admirer of your nation and of its history," he told an American correspondent in 1901, "and it is my desire that our relations should be as cordial, as sympathetic, and as friendly as it is possible to make them. I shall always strive towards that object."[7] Despite the Alaskan Boundary controversy in 1903 and the bitterness which it generated, he was as good as his word. Although he, himself, remained largely in the background, he supported a proposal three years later that Canada and the United States attempt to settle all outstanding differences between them, and that support was constant and, at times, vital.[8]

During the next few years, as a result, a number of issues in Anglo American diplomacy were skillfully disposed of. The long-standing fisheries question – provisions in the Anglo-American Convention of 1818, limiting American fisheries vessels from access to British North American inshore waters – was referred to the Hague Tribunal.[9] No less important, though certainly less spectacular, were treaties for the final demarcation of the boundary between Canada and the United States, agreements on the conveyance of prisoners, wreckage and salvage operations, and on the Passamaquoddy Bay frontier question.[10] And on the eve of the opening of tariff negotiations, two other issues were well on the way towards a successful resolution: one involved the regulation of the exploitation of fur seals in the North Pacific, the so-called Bering Sea dispute; the other was the Boundary Waters Treaty, signed, but not ratified in 1909, establishing the International Joint Commission to regulate the use of water resources common to the two countries.[11]

The one remaining problem in Canadian-American relations was trade arrangements satisfactory to both countries. Unlike the other issues in Canadian-American diplomacy, this was a political question as well, though it shaped the context of the negotiations in the slate-clearing process in a number of ways. In 1907, after an extensive cross-country inquiry, the Laurier government had modified its tariff structure by inserting an intermediate tariff level between the British preference and the general rates which it might grant to other countries by commercial treaty. The object was to reach more satisfactory trade arrangements with non-British nations on the basis of reciprocal agreements below the general rates. Consequently, later that year, agreements were reached, though limited in scope, with France, Japan and Italy. The Americans, too, were then in the process of revising their tariff. In 1909, the American Congress passed the Payne-Aldrich Act, setting the previous level of protection as its minimum level, and establishing a 25 per cent higher maximum level to be applied to trading partners judged to be discriminatory in their trade practices against the United States. In the official view of the American government, the Franco-Canadian convention represented such discrimination, and it threatened to apply its new maximum penalty rates to Canadian imports unless Canada granted equivalent concessions to the United States.

From the Canadian standpoint, the American position was patently untenable. As Laurier put it, it was a reversal of the latter's traditional interpretation of the favoured nation idea. It asked, in effect, that Canada grant to the United States the Canadian intermediate rates, which Canada had granted to France for a consideration, for nothing, ie., the minimum schedule enjoyed by every other country under the Payne-Aldrich Act.[12] Apart from the threat this implied to Canadian commercial sovereignty, the American position, as the Canadians saw it, was based on a misconception of the French treaty itself. Laurier maintained that it constrained nothing that was new and was "simply an extension of a treaty which has been in existence since 1783. It was not conceived with any intention of discrimination against the United States and, in fact does not discriminate against them. We do not buy from the United States a dollar's worth of what we may import from France under its terms."[13] All of this meant that from a political standpoint, Laurier had little room for manoeuvrability. As a former colleague pointed out, "apart from the selfish manufacturers who cannot have too high a tariff, there are many independent minded people who very properly resent Yankee bullying . . . and would deeply regret Canada's submission to the coercion of our big neighbours."[14]

Whatever bullying there might be, however, Laurier believed that he was dealing from a position of strength. From a commercial standpoint, he felt, there was not much to be concerned about, even if the Americans imposed the maximum rates. "What we may lose in one way," he pointed out privately, "we will more than make up by our external development and the substitution of other markets abroad."[15] The abrogation of the Reciprocity Treaty of 1854 was a case in point. "Their action at that time certainly hurt us, but on the whole it was for us a blessing in disguise. It threw us upon our own energy and we more than made up the temporary loss."[16] In any case, there was reason to believe that the imposition of the American tariff would not affect American exports as much as might be expected. "We sell them some 90 millions of dutiable goods," Laurier was advised, "which some 60 millions are wood and products of wood and some 20 millions gold and silver, leaving a very small amount for miscellaneous products of our country." And as for wood, under the American system of drawbacks, the amount collected as duty was "immaterial, it being nearly all returned to the importer."[17]

Laurier also believed that he held at least two high cards in any negotiations with the United States. Of concern to the Americans – to the American newspaper publishers in particular – was the possibility that the Quebec provincial government might prohibit the export of pulpwood cut from crown lands, a decision it had announced in the previous September. Although this was primarily a matter of provincial concern, Laurier was not without influence with the Quebec premier, Lomer Gouin, and his cabinet colleagues. Laurier, for his part, had already let it be known that the federal government was ready to impose export duties on pulp, pulp-wood and nickle should the Americans penalize Canada.[18] "Our power to do so is our Ace of Trumps," the governor-general, Lord Grey, told the Colonial Office, "and I do not think Canada will weaken her hand by playing it out until she is satisfied that by so doing she can secure several tricks."[19] The other high card in Laurier's hand was the still unratified Boundary Waters Treaty which he had been sitting on for a number of months. Whether this was the trump Laurier appears to have believed is open to question. According to the British Ambassador in Washington, James Bryce, the principal architect of British strategy in the negotiations with the United States, it was "for Canada a far better bargain that she will ever get again. We should never have got it from the State Department as at present constituted."[20] Nevertheless, Laurier informed the Governor-General that we will have to hold back on this and unfortunately on many other things if we are to have commercial non-intercourse proclaimed on the 31st of this month."[21]

For Laurier, however, the problem was one of more than economics: it was also a problem of Canadian-American relations. And in the final analysis, the concern not to jeopardize the new spirit of accommodation which had gradually replaced the animosity engendered by the Alaskan boundary award appears to have been decisive. The fact of the matter was that Taft's own position was awkward at best. He was reluctant to impose the trade penalties called for in the Payne-Aldrich Act, and even more, was under heavy pressure from Democrats, the low tariff wing of his own party, as well as high tariff eastern newspaper publishers in search of cheap paper, to lower the tariff. Certainly all the signals Laurier was receiving from south of the border confirmed that the Americans had "little fight in them" and had little interest in a tariff war with Canada.[22]

In the middle of February, the first feeler arrived from the British Embassy in Washington as to possible ways of getting Taft off the hook. Conveying an unofficial proposal from the chairman of the newly-created Tariff Board, Henry C. Emery, the British Chargé d'Affaires suggested that "if Canada could make some concession to the United States either in regard to some of the articles covered by the French Treaty, or in the matter of the export of wood pulp, it would give great satisfaction to everybody here."[23] Bryce expanded on this initiative one week later. Sensitive to the dilemma Taft found himself in, and himself, concerned lest anything disturb the tranquil diplomatic waters between Canada and the United States with important questions in the slate-clearing process still to be dealt with, Bryce explained that the president was being pushed from two different quarters to perform his statutory duty: protectionists, including those in the State Department, who asked what purpose the maximum scale served if it was not used to pry concessions out of a country which gave other countries more favourable terms than the United States; and the paper-making interests who argued that the removal of the tariff would inevitably lead to a migration of paper mills to Canada where production and raw material costs were lower. Unofficially, it appears, though following further meetings with members of the Tariff Board, Bryce asked whether there might be some way of alleviating the president's dilemma and strengthening his hand in the face of these forces. Specifically, he wondered whether assurances could be given that the export of woodpulp from Quebec would continue. As well, he asked whether the Canadian government would receive members of the Tariff Board to discuss the situation with it. "This would strengthen the party which wants to avoid any trouble," Bruce pointed out, "whereas a refusal to listen might weaken them and help the belligerent spirits. . . . When people want to climb down decently and save their faces, while practically conceding everything, it is generally best to let their faces be saved."[24] The point it would seem, was a telling one. As Laurier later pointed out, "it would have been a shame and a disgrace for our party to refuse the overtures made to us by our neighbours."[25]

Besides, it created an opportunity which had always interested Laurier. "A free trader sound in theory, but somewhat deficient in practice," he had recently described himself, and the time was now ripe to put theory into practice.[26] During the first week in March, Laurier and his minister of finance, W.S. Fielding, met with J.G. Foster, American Consul General at Ottawa, Charles M. Pepper of the U.S. State Department, and Henry Emery, representing the Tariff Board. According to Foster's account, the Canadians began the discussion by asking what concessions the Americans were prepared to offer. And when the latter suggested the opening of wide-ranging discussions on the tariff relationship between the two countries, Laurier jumped at the proposal.[27] In a memorandum which he prepared for the secretary of state, Philander C. Knox, Pepper recorded that "Laurier replied with such earnestness that while he had once thought he never would go to Washington again, yet if a means of readjusting the tariff relations on the lines indicated could be found he would be ready to go himself.[28] In Foster's mind, this was the beginnings of the reciprocity movement.[29] As a gesture of good faith, Laurier immediately wrote Gouin asking that no discussion take place in the upcoming session of the provincial legislature regarding the export prohibition of woodpulp,[30] and when an emissary sent to Quebec returned with an indication that the Quebec premier might be willing to reconsider the question, the American delegates concluded there was room for further negotiations.[31]

What was needed now was some face saving arrangement for Taft. The solution was found in a proposal put by the president to the Rev. J.A. Macdonald, the editor of the Toronto *Globe*, and one of Laurier's political confidants, who was visiting Washington, ostensibly on a private visit, during the second week of March. The proposal essentially was that Canada grant to the United States its intermediate rate on a limited number of articles of no great significance, "on articles in which there is practically no competition between the United States and Canada"—as it was eventually worked out, on 13 of the 100 articles contained in the French convention ranging from prunes to window glass.[32] Following meetings in Albany, New York, between Taft, Fielding, and Lord Grey on March 19 and 20, and a final meeting in Washington between Fielding and Taft, the last details of the arrangement were hammered out. To allow Canada to be able to state that no special concessions had been granted to the United States, Parliament would enact legislation giving the same rates on the 13 items to the rest of the world. As one economist observed, "a phantom concession had been made to remove an invented grievance."[33]

These discussions, however, did more than head off a potential tariff war with the United States. The course had been set for full scale reciprocity negotiations between the two countries. Certainly all signs pointed in this direction following the meetings in Albany. In an unprecedented gesture of goodwill to Canadians, Taft presented Macdonald with a personal message which was printed in the Toronto *Globe* on March 21. The president proclaimed that it was his purpose to "promote, in such ways as are open to me, better trade relations between the United States and Canada than at present exist." He noted that the two countries "touching each other for more than three thousand miles" had "common interests in trade" and required "special arrangements in legislation and administration" which were "not involved in the relations of the United States with nations beyond the seas. We may not always have recognized that in the past but there must be our viewpoint in the future."[34] On the Canadian side, the commitment was as firm. In an exchange of correspondence with the American secretary of state on March 26, Fielding affirmed that "the Canadian Government would gladly avail themselves of the invitation of the President to take up with your Government, at such time and in such manner as may be mutually satisfactory, the consideration of a readjustment of these relations upon broad and liberal lines."[35] And on March 31, Grey officially informed the Colonial Office that "mutual assurances" had been given "that negotiations will be entered upon later with a view to closer trade relations between the two countries."[36]

Four months, then, before his trip to Western Canada, Laurier had made the commitment to begin negotiations with the United States. Indeed, had it not been for the fact that parliament had prorogued, the cabinet had dispersed and that Fielding had previous plans to journey to England, formal negotiations might have begun as early as May as the Americans formally suggested.[37] The farmers, to be sure, were not without a role in the reciprocity story. Laurier, for his part, was decidedly unimpressed with their plight when he met them in July. "It always appeared to me," he told the premier of Saskatchewan privately, "that there was more politics than graingrowing in the different addresses with which I was favoured.[38] To the governor-general, he was even more candid. " 'The West' has just invaded Ottawa," Grey informed the Colonial Secretary, following their trek to Ottawa in December, "a fine group of prosperous farmers, the poorest of whom Sir Wilfrid tells me is supposed to be worth $10,000. . . . He has chaffed them about their wealth, and professed a desire to share their complaint."[39] Laurier, however, needed a show of strength on the part of the western farming community. It was needed, however, not so much to suggest the wisdom of opening reciprocity negotiations with the United States. He needed it primarily to strengthen his hand in dealing with the critics of reciprocity in eastern Canada, particularly in Ontario. That, however, is another chapter altogether.

Notes

1. J.S. Willison, *Sir Wilfrid Laurier and the Liberal Party. A Political History* (London, 1903), vol. 1, p. 363.

2. Public Archives of Canada, Laurier Papers, Laurier to John Charlton, August 20, 1901. See also Laurier to G.A. Copeland, November 12, 1900; Laurier to Copeland, November 20, 1901; P.A.C., Grey Papers, Memorandum of a conversation with Sir Wilfrid Laurier, January 9, 1905.

3. Henry Borden, ed., *Robert Laird Borden: His Memoirs* (Toronto, 1938), vol. 1, p. 303.

4. Robert Cuff, "The Conservative Party Machine and the Election of 1911 in Ontario," *Ontario History*, September, 1965, pp. 149-56; Paul D. Stevens, "Laurier, Aylesworth, and the Decline of the Liberal Party in Ontario," Canadian Historical Association, *Historical Papers*, 1968, pp. 94-113; A. Gordon Brown, "Nova Scotia and the Reciprocity Election of 1911," (unpublished M.A. Thesis, Dalhousie University, 1971); Richard Johnston and Michael B. Percy, "Reciprocity, Imperial Sentiment, and Party Politics in the 1911 Election," *Canadian Journal of Political Science*, XIII, 4, December 1980, pp. 711-29; M.B. Percy, K.H. Norrie, and R.G. Johnston, "Reciprocity and the Canadian General Election of 1911," *Explorations in Economic History*, 19, 1982, pp. 409-434.

5. See, for example, L.E. Ellis, *Reciprocity, 1911. A Study in Canadian American Relations* (New Haven, 1939); R.C. Brown and Ramsay Cook, *Canada. 1896-1921. A Nation Transformed* (Toronto, 1974); J.L. Granatstein, "Free Trade Between Canada and the United States: The Issue that Will Not Go Away," in Denis Stairs and Gilbert R. Winham, *The Politics of Canada's Economic Relationship with the United States* (Toronto, 1985), pp. 11-54.

6. Paul D. Stevens, "Laurier and the Liberal Party in Ontario, 1887-1911," (unpublished Ph.D. dissertation, University of Toronto, 1966), pp. 369-406.

7. Laurier Papers, Laurier to G.A. Copeland, November 12, 1900.

8. P.A.C., Pope Papers, Text of Laurier's response to Elihu Root, September 25, 1906; Grey Papers, Laurier to Grey, September

29, 1906; A.C. Gluek, "Pilgramages to Ottawa: Canadian-American Diplomacy, 1903-13," C.H.A., *Historical Papers*, 1968, pp. 65-83; Peter Neary, "Grey, Bryce, and the Settlement of Canadian-American Differences, 1905-1911," *Canadian Historical Review*, XLIX, 4, December 1968, pp. 357-380; C.P. Stacey, *Canada and the Age of Conflict*, Vol. 1 (Toronto, 1977), pp. 85-121.

9. Gluek, "Programmed Diplomacy: The Settlement of the North Atlantic Fisheries Question, 1907-12," *Acadiensis*, VI, Autumn 1976, pp. 43-70.

10. Gluek, "The Passamaquoddy Bay Treaty, 1910: A Diplomatic Sideshow in Canadian-American Relations," *C.H.R.*, XLVII, 1, March 1966, pp. 1-21.

11. Alan O. Gibbons, "Sir George Gibbons and the Boundary Waters Treaty of 1909," *C.H.R.* LXIII, 11, June 1982, pp. 179-201; Gluek, "Canada's Splendid Bargain: The North Pacific Fur Sea Convention of 1911," *C.H.R.*, LXIII, 2, June 1982, pp. 179-201.

12. Laurier Papers, Laurier to W. Nesbitt, November 23, 1909.

13. Laurier Papers, Laurier to James Bryce, February 9, 1910.

14. Laurier Papers, William Mulock to Laurier, March 18, 1910.

15. Laurier Papers, Laurier to Andrew Macphail, March 21, 1910.

16. Laurier Papers, Laurier to W. Nesbitt, November 23, 1909.

17. Laurier Papers, William Mulock to Laurier, March 18, 1910.

18. Grey Papers, Grey to Bryce, November 22, 1910. The struggle between the American newspaper publishers and the pulp and paper manufacturers is analyzed in L.E. Ellis, *Print Paper Pendulum: Group Pressures and the Price of Newsprint* (New Brunswick, New Jersey, 1945), pp. 3-38. See also H.V. Nelles, *The Politics of Development. Forests, Mines and Hydro-Electric Power in Ontario* (Toronto, 1974), pp. 333-47.

19. Grey Papers, Grey to Lord Crewe, March 4, 1910.

20. Grey Papers, Bryce to Grey, March 21, 1910.

21. Grey Papers, Laurier to Grey, March 15, 1910; Bryce to Grey, March 17, 1910; Grey to Bryce, March 18, 1910.

22. Grey Papers, George Young to Grey, February 18, 1910.

23. Grey Papers, A. Mitchell Innes to Grey, February 18, 1910.

24. Grey Papers, Bryce to Grey, February 25, 1910.

25. Private Collection, Sinclair Family Papers, Laurier to J.H. Sinclair, September 27, 1911.

26. Laurier Papers, Inscription in a copy of a translation of Bastiat's Fallacies of Protection (London, 1909) presented by Sir Wilfrid Laurier to W.C. Edwards, September, 1909.

27. Douglas Library, J.G. Foster Papers, Memorandum by Wm. S. Culbertson of the United States Tariff Commission in Culbertson to Foster, September 10, 1917.

28. April 19, 1910; quoted in Ellis, *Reciprocity, 1911*, p. 40.

29. Foster Papers, Culbertson Memorandum, September 10, 1917.

30. Laurier Papers, Laurier to Lomer Gouin, March 10, 1910.

31. Ellis, *Reciprocity, 1911*, pp. 40-1.

32. Grey Papers, Bryce to Grey, March 14, 1910.

33. O.D. Skelton, *Life and Letters of Sir Wilfrid Laurier*, Vol. II (Toronto, 1921), p. 366.

34. *The Globe*, March 21, 1910.

35. Quoted in Ellis, *Reciprocity, 1911*, p. 45.

36. C.O. 42/937, Telegram, Grey to Lord Crewe, March 31, 1910. See also Confidential Dispatch, Grey to Lord Crewe, March 31, 1910.

37. Grey Papers, Grey to Bryce, May 16, 1910; Bryce to Grey, May 17, 1910; Grey to Bryce, May 17, 1910.

38. Laurier Papers, Laurier to Walter Scott, August 20, 1910.

39. Grey Papers, Grey to Loulou Harcourt, December 19, 1910.

Reciprocity 1911: Through American Eyes

Tom Velk and A.R. Riggs

In our opinion the only meaningful, large question to be raised by the historian about American acceptance of reciprocity with Canada in 1911 is 'why?'. That was the question posed by the standard monograph devoted to the negotiations, *Reciprocity 1911*, by Lewis Ellis. But the historian's answer to the question in 1939 was different from ours. Ample room for disagreement exists primarily because no reliable public opinion polls were taken in 1911. Ellis substituted a careful and fairly representative study of press opinion. He was rightly wary of newspapers as the handmaidens of public opinion, but, in our view, he erred on the side of skepticism. Several times in his book he strongly intimated that the American press in 1911 manipulated both the President and public opinion to accept free trade with the disingenuous motive of obtaining cheaper newsprint for themselves from Canada.[1]

This was not a novel idea in 1939, nor was it new in 1911. The opposition to Canadian-American reciprocity in Congress, consisting of conservative Republicans and a group known collectively as rural insurgents or progressives, claimed that the prospect of free trade in pulp and newsprint paper was largely responsible for a press favourable to reciprocity. But what rendered Ellis' study so potent just before World War II, in addition to an economic interpretation of the Congressional vote, was a factor then thought to be an even stronger motivator than greed – propaganda. In the light of what was going on in Europe, some historians thought they had found a universal explanation for hitherto unexplained swings in public opinion, and they attributed numerous events in history, including the American Civil War and the Revolution to propaganda. In our view, however, the overwhelming vote in both houses of Congress in favour of Canadian-American reciprocity in 1911, when explained in this way, seriously distorts the attitude and mood of the American people.

It must be remembered that for over a decade in 1911 progressive reformers had been gaining public support in the United States. As politicians they operated honest and efficient government in cities and states; as "muckrakers" by 1902 they had gained control of many periodicals where they preached morality and exposed sin wherever they could find it; and as reformers they infiltrated both parties on a national level, primarily the Republican organization. A major goal of progressives was to sever the bonds between organized business and organized politics, to "bust the trusts," in the language of the day. Years of high tariffs had been a key factor in the rise and continued domination of American life by industrial leaders, some of them "heejous monsters," in Theodore Roosevelt's words. Thus lowering the tariff was a popular aim, and it was the first item on William Howard Taft's legislative agenda when he came to power in 1909.

How did it happen that a new Republican president, as the first major act of his administration, brought in a bill to lower the tariff? The Republican Party, from its founding in 1854, had favored high tariffs, and the Democratic Party, founded earlier on a shaky alliance of the South and West, fought for low tariffs. After the Civil War, with Republicans in power most of the time, the key domestic issue was the tariff, which soared to an all-time high in the 1890's with the McKinley and Dingley Acts. The Dingley Tariff of 1897 raised rates *ad valorem* to approximately 40.2 per cent on hundreds of items.[2]

Theodore Roosevelt, in power from 1901 to 1909, sedulously avoided a legislative battle with conservatives in Congress over the tariff because he judged correctly that the people were not quite ready to render a collective judgment on the issue. Furthermore, the standpat Republican leaders in Congress, who had protected their peers in industry for many profitable years, were unwilling to recant. Taft, who wanted to be a progressive as much as he wanted to take command of Roosevelt's liberal forces, was T.R.'s hand-picked successor. The ambiguous platform Taft ran on in 1908 asked "unequivocally for the revision of the tariff."[3] The losing Democratic Party in 1908, as usual, wanted a lowering of duties and a tariff for revenue only.[4]

The bill Taft sponsored in the House in 1909 reduced rates on iron and steel products, agricultural implements, sugar and lumber, in addition to naming important raw materials for the free list. In the Senate, however, it was sandbagged by standpat Republican leaders, headed by Nelson Aldrich of Rhode Island, with 847 amendments, a majority effecting increases.[5] Confounding many of his friends, the President supported the mutilated Senate version, even when accompanied by the rising anger of the insurgents or progressives in his own party, many of whom came from the farm-belt Midwest. Instead of lowering the Dingley rates, the so-called Payne-Aldrich Act, signed by the President in August 1909, raised rates to an average of almost 42 per cent.[6]

President Taft lost credibility with the public by signing a high tariff, but by 1910 there were several reasons why he would sponsor a reciprocal lowering of duties across the board with Canada. First, he had served Theodore Roosevelt as appointed governor of the Philippine Islands, and had watched a successful reciprocity agreement in action there.[7] Second, Taft had an uncomfortable obligation pressing on him to take retaliatory action against discriminatory Canadian tariff rates of 1907, a mandate spelled out in the Payne-Aldrich Act that carried with it the threat of a trade war.[8] Third, Taft genuinely believed that reciprocity would aid both countries, but most importantly the United States.[9] With the exception of Great Britain alone, Canada was the chief trading partner of the United States, and the balance of payments situation was already very favourable to his own country. In 1910 Canada bought goods in the amount of $242,000,000 and sold the United States goods, mainly raw materials, in the amount of $97,000,000.[10]

The President was confident that if he could force an agreement with Canada through Congress, there should be little trouble for the government of Sir Wilfrid Laurier in getting the Canadian Parliament to agree. This was because the Canadians had always taken the initiative for reciprocity in the past, until, frustrated, Laurier announced in 1896, "We make no more pilgrimages." On Taft's powerful initiative in September 1910, Canadian negotiators met in Ottawa with American pilgrims, and eventually an agreement emerged that President Taft presented to Congress with a special message on January 26, 1911.[11]

The Presidential message received thunderous applause in Congress, but the joint agreement soon came under attack from those who believed it did not go far enough. The *New York Times* discovered in March 1911 that Canadian Finance Minister W.S. Fielding had frustrated the American commissioners because at the outset he said, "We are not prepared to have manufactured articles included in the list for reciprocity."[12] According to a study by The United States Tariff Commission in 1919, "the Canadian duties fixed in the agreement corresponded closely with the rates of the Canadian intermediate tariff of 1907." The Commission further noted,

> The prime object of the conferees was to arrange for the admission to the United States of Canadian agricultural produce, fish, and raw materials. Having settled upon this, the conferees took the Canadian intermediate tariff and selected from it certain items which the United States exported in considerable quantities and upon which the American members asked for the lowest rates possible. But upon nearly all of these the Canadians would consider no reduction below the terms of the intermediate tariff. The only important exceptions were cottonseed oil, galvanized or tinned sheets, and typesetting and typecasting machines, all of which were added to the free list . . . it is difficult to see how the export of American manufacturers would have been materially affected.[13]

In summing up, the Tariff Commission took a general look at the agreement:

> By this agreement Canada was to obtain practically everything that she had formerly sought by way of reciprocity, while her concessions were to be little more than those which she had already extended to most countries, but not to the United States, through the operation of her conventional tariff.[14]

In Washington Senators and Representatives, in particular Republican insurgents from farm-belt states bordering Canada, who were philosophically in favour of free trade, made precisely the same points as the Tariff Commission. Senator Coe I. Crawford, for example, approved of free trade, but he spoke for many of his progressive colleagues when he said,

> Canada herself makes this impossible. It is her firmly established policy to build up her own manufacturing industries under a protective tariff, and we can not persuade her to change that policy . . . it will give to Canada free admission into the markets of the United States for her farm products without a sufficient "quid pro quo." She will have secured what she wants without giving us anything in return.[15]

We have arrived now in this paper at our original question. If the Senator from North Dakota spoke the truth, and we believe he did, why were the President and Congress so willing in 1911 to accept a trade agreement which held out only limited advantages for their country? The answer, we believe, lies not in deception of the people by a media hungry for cheaper paper, but in a wide-spread belief by the public that the rising cost of living resulted from high tariffs, and specifically from the wrong-headed Payne-Aldrich Act of 1909. They would have preferred true reciprocity, even in farm areas, for free exports from Canada could not have affected prices of food and consumer goods very much.[16] There is good evidence to show that the only strong opposition to the agreement came from farm areas in border states, with progressive support because manufactures were still protected and food products were not.

In fact, by 1911 progressive anti-tariff attitudes had gained broad acceptance in the United States, and great numbers in both parties were now ready to lower the tariff. "This country is really willing to agree with Canada on everything except which side of the road to turn out when driving," said the Brooklyn *Standard Union*.[17] The *New York Times* noted on February 26, 1911, that reciprocity was "backed by such a force of public sentiment as we do not recall behind any other measure in our political history." A poll of business leaders in Eastern cities by the *Times* found them opposed to general revision, but "Eager for Canadian Reciprocity."[18] Summing up American press opinion on February 11, 1911, *The Literary Digest* wrote: "Editorial opinion, regardless of party or section, seems to be rallying to the support of what one correspondent calls the "first Taft policy."[19]

Even in the agricultural Midwest, and in areas farther west and south, no great opposition developed to reciprocity. In June 1911, a Chicago *Tribune* poll of 10,000 editors in 22 Western states got 4,190 responses, three to one in favor of the agreement.[20] "In the East and South," said the *Literary Digest*, "we find the Reciprocity Bill indorsed with equal cordiality by Republican, Democratic, and Independent editors."[21]

It will not do to attribute the press support merely to the desire for free pulp and newsprint paper, a charge made by Senator Robert LaFollette of Wisconsin and others, during the Congressional debates.[22] The *New York Times* admitted that newspaper owners are human, and the cost of newsprint paper was excessive, but, said the *Times*, "Mr. LaFollette knows that the principal aim of all the newspapers is to print the news."[23]

The press, in this instance, was certainly correct. They were not making propaganda but reflecting the genuine aspirations of the people. When the reciprocity agreement was under debate both houses of Congress were flooded with favourable resolutions, petitions and memorials. State legislatures voting their approval included Maine, Massachusetts, Connecticut, New Hampshire, New York, Kansas and Colorado. Even Minnesota, a farm state, refused to instruct her Senators and Representatives to vote no.[24]

The first vote in the House, over the objections of the Republican Speaker, Joseph Cannon of Illinois, was 221 to 96, and the second, on April 21, 1911, with Democrats now in control, was 268 to 89.[25] Even more revealing was the vote during special session in the United States Senate, 53 to 27, where approximately 15 progressives took up the embarrassing task of opposing a bill embodying a concept they actually agreed with in order to serve the farmers.[26]

Much of the opposition of farmers was genuine, especially among jittery wheat growers of the West, but too much of it was also provided for them by a lobbying organization, Allen and Graham, of New York City. In May 1911 Senate Finance Committee hearings revealed that the hundreds of articulate petitions and resolutions flooding Congress from Grange organizations, against reciprocity, were drawn up by Whidden Graham, a Canadian expatriot who turned the National Grange, with a membership of approximately 425,000, into a stalking-horse for two other Allen and Graham clients, the International Paper Company, or Paper Trust, and the Timber Trust. With much to gain by denying Canadian competition, these businesses had promised to pay the bills for the Grange campaign.[27] As Representative Claude Kitchin of North Carolina said,

> Every Democrat and every Republican on this floor knows that the two great organizing forces behind the opposition are the International Paper Company, known as the Paper Trust, that controls 80 per cent of all the paper used throughout the length and breadth of this country from the big metropolitan daily to the smallest country weekly, and the Lumber Trust and timber kings of the West, who own and control over 80 per cent of the standing timber in the United States. They have organized the protected forces against it, and pretending great anxiety for the agricultural interest, have had the shrewdness to play upon the fears and to alarm some of the farmers against it.[28]

Most people by 1911 believed that in order to do battle with the trusts the tariff must be drastically revised, and that is what provided the real drive for Canadian-American reciprocity. For evidence of this we need only to consider the Congressional elections of 1910, a stunning blow to Taft that brought in a Democratic House and guaranteed that Democrats with insurgent help could control the Senate. The first goal of the new Democratic Congress was to lower the tariff, and the results, the Underwood Bill of 1913, became America's first low tariff since before the Civil War.

It should be added in conclusion that, aside from fears of annexation and encroachment on her cultural sovereignty, Canada was placed in a classic "no lose" situation by the American elections of 1910. The United States had telegraphed its intent before the battle was even joined. Canada could accept an agreement advantageous to her, or wait until Democrats lowered the tariff, unilaterally, with even greater concessions. In the eyes of many Americans she chose to wait for a better deal.

Notes

1. L. Ethan Ellis, *Reciprocity 1911; A Study in Canadian-American Relations* (New York, 1939), pp. 85-86; 137-38. In his conclusion, p. 191, Ellis said that the President "entered upon reciprocity, if not at the direct behest of the American Newspaper Publishers' Association, at least in close harmony with that group's desires," a statement that proves nothing.

2. Arthur S. Link and William B. Catton, *American Epoch; A History of the United States Since 1900* (New York, 1980), I, 97.

3. *Ibid.*; Ellis, p. 8. Theodore Roosevelt was mainly responsible for the pledge, and the ambiguous wording.

4. Sidney Ratner, *The Tariff in American History* (New York, 1972), p. 41.

5. Richard C. Baker, *The Tariff Under Roosevelt and Taft* (Hastings, Neb., 1941), pp. 81ff; Link and Catton, p. 97.

6. Link and Catton, p. 97.

7. *New York Times*, February 13, 1911.

8. "Reciprocity With Canada; Address of the Hon. Philander C. Knox, March 3, 1911," *House Documents* (Washington, 1911), Vol. 124, p. 3.

9. "Documents Relating to Reciprocity With Canada," 61st Cong., 3rd Sess., *Senate Documents* (Washington, 1911), p. ix.

10. "Effects of the Reciprocity Victory," *The Literary Digest*, XLIII (August 5, 1911), 191.

11. P.T. McGrath, "Will There be Reciprocity Between the United States and Canada?," *The American Review of Reviews* XLIII (January, 1911), 42; also see, *Ibid.* (March, 1911), p. 278.

12. *New York Times*, March 16, 1911.

13. *Reciprocity and Commercial Treaties*, United States Tariff Commission (Washington, 1919), p. 374.

14. *Ibid.*, p. 375.

15. *The Congressional Record*, Washington, 62nd. Cong., 1st Sess., p. 1039.

16. See, for example, a speech by Senator Albert J. Beveridge of Indiana, that makes this point, in *Congressional Record*, Washington, 61st Cong., 3rd. Sess., p. 2181. See also, *The Nation* XCII (February 23, 1911), 106.

17. *Literary Digest*, XLII (February 11, 1911), 238.

18. *New York Times*, March 7, 1911.

19. *Literary Digest*, XLII (February 11, 1911), 237.

20. Ellis, *Reciprocity 1911*, p. 138.

21. *Literary Digest*, XLII (February 11, 1911), 237.

22. *Ibid.*, XLIII (July 29, 1911), 161; Speech of Senator Dixon (Montana), July 10, 1911, *Congressional Record*, 62nd Cong., 1st Sess., p. 2772, and Speech of Senator LaFollette (Wisconsin), July 21, 1911, *Ibid.*, p. 3139.

23. *New York Times*, June 28, 1911.

24. *New York Times*, February 2, 10, 13, 14, 16, 28, 1911; *Literary Digest*, XLII (February 25, 1911), 346; *American Review of Reviews* XLIII (March, 1911), 280; *Congressional Record*, 62nd Cong., 1st Sess., p. 1049.

25. Henry F. Pringle The Life and Times of William Howard Taft (New York, 1939) II, 593; Ratner, *The Tariff in American History*, p. 44.

26. See an analysis of the Senate vote in *New York Times*, July 24, 1911. If the 12 Republican progressives, in principle favouring tariff reduction, had voted yea the margin for tariff reduction would have been four to one.

27. Ellis, pp. 121-23, 132,34; *New York Times*, May 26, June 1, 1911.

28. *Congressional Record*, 62nd Cong., 1st Sess., April 15, 1911, p. 287.

*Trends in Canada-U.S. Free-Trade Discussions: 1911-1986**

Earl H. Fry

Introduction

The United States and Canada, North American neighbours who already enjoy the largest bilateral trading relationship in the world, are currently engaged in formal free-trade discussions. These discussions are crucial for two significant reasons. First of all, the bilateral economic stakes are very high, with Canada sending more than three-quarters of all its exports to the U.S. market, with these exports accounting for about 25 per cent of Canada's annual gross national product. For its part, the United States, which still ranks as the number one trading nation in the world, dispatches one-fifth of all its exports to Canada. Too many Americans fail to understand Canada's importance to the health and vitality of the U.S. economy, for U.S. firms actually export more goods and services to Ontario than to Japan, more to British Columbia than to China, and more to Alberta than to France.

Secondly, the relative success or failure of the bilateral discussions will certainly have a noticeable impact upon GATT's new Uruguay Round. If geographic neighbours engaged in the largest bilateral trading relationship in the world cannot reach agreement on such complex issues as trade in services and agriculture, investment liberalization, intellectual property protection, or government procurement, then how can one expect that the highly diverse 92-member GATT organization will ever reach a consensus on these issues? Indeed, many hope that what might be agreed to by Ottawa and Washington will serve as the prototype for the eventual Uruguay Round agreement.

---

* A portion of this paper was adapted from an earlier presentation to L'Association Québécoise des Études Américaines.

This paper will briefly trace Canada-U.S. bilateral trade discussions during the 20th Century and point out some historical lessons which might be of value to the current negotiating teams headed by Simon Reisman and Peter Murphy.

The Reciprocity Crisis of 1911

The only major comprehensive trade pact ever implemented by the United States and Canada was the Elgin-Marcy Reciprocity Treaty in 1854. This pact permitted the free exchange of such natural products as fish, animals, butter, cheese, coal, flour, grain, and timber. The U.S. Senate abrogated this treaty in 1866, partially as a result of resentment toward Great Britain's support of the Confederacy during the Civil War, and partially as a rebuke for new tariffs introduced in British North America. The Canadians tried to revive the pact in the 1870s, but the Senate continued to be a stumbling block.[1]

Even after Sir John A. Macdonald introduced the highly protectionist National Policy in 1879, sporadic trade discussions were held between Washington and Ottawa. Nonetheless, serious discussions geared toward the creation of a comprehensive trade accord were not held again until 1911. At this time, the Liberal government of Wilfrid Laurier negotiated a new reciprocity trade agreement with the United States. In January 1911, a text of a new Canada-U.S. trade agreement was announced in the House of Commons and by President William Howard Taft at the White House. Over a period of 38 years, Taft had spent part of his summers at Murray Bay on the St. Lawrence, and he manifested a strong personal interest in strengthening Canada-U.S. trade relations. The 1911 announcement was fairly similar to the 1854 pact, and most U.S. tariffs on manufactured goods were to be reduced, whereas most Canadian manufacturing tariffs would remain in place.[2] The legislation approving the agreement was to be passed in exact form by Parliament and by Congress, and would not be considered as a treaty. This plan would keep Great Britain out of the process and also negate the need for a two-thirds vote in the U.S. Senate, the constitutionally-mandated majority required for the ratification of any treaty. In July 1911, the two chambers of the U.S. Congress finally passed the legislation and President Taft signed it into law. In Canada, however, Robert Borden's Conservative Party staunchly opposed the trade legislation and easily defeated Laurier's Liberals in the 1911 general elections. The new Conservative government never put the reciprocity agreement to a vote, and the U.S. Senate eventually rescinded its 1911 vote eight years later.[3] Ironically, in spite of the 1911 setback, Canada soon benefited substantially from U.S. trade liberalization when Congress passed the Underwood-Simmons Act in 1913, marking the first significant attempt in many decades to lower U.S. tariffs.[4]

The Turbulent 1930s

In response to the deepening economic depression, the U.S. government enacted the infamous Smoot-Hawley Tariff in 1930, raising the average tariff on dutiable goods to a record high 59 per cent. This blatantly protectionist policy certainly limited the shipment of goods into the United States, with imports in 1932 falling back to 1909 levels. On the other hand, the trade war which ensued helped to increase U.S. unemployment to a staggering 25 per cent, and real per capita income retreated to the same level achieved back in 1907. Congress also passed the Buy American Act of 1933, and although no preference levels were mandated, successful foreign bidders were often required to come in with bids at least 25 per cent below those submitted by Americans contractors.[5]

Franklin Roosevelt's entry into the White House in 1933 was to mark a gradual turnaround in Washington's views toward trade protectionism. The Trade Agreements Act of 1934 (also known as the Hull Act) was intended to cut tariffs by up to 50 percent in return for reciprocity pacts with other major trading nations. Approximately 20 such reciprocity agreements were negotiated by 1939, including two important agreements with Canada in 1935 and 1938. In a passage reflecting Canada's need for access to U.S. markets, Prime Minister Mackenzie King wrote in his diary that the 1935 Canada-U.S. trade pact was "the greatest political accomplishment of my life."[6]

World War II and the Post-War Period

In 1940, the United States and Canada signed the Ogdensburg Agreement which created a Joint Defence Board, and a defence production sharing arrangement was made possible through the 1941 Hyde Park Declaration. In 1944, duties on all agricultural machinery and implements were also removed by the two neighbouring countries.[7]

Wartime demands also precipitated greater cooperation on a continental basis. The United States and Mexico appointed a joint defence board and Mexico and Canada became prime sources of raw materials for U.S. factories. In addition, Presidents Roosevelt and Camacho reached an agreement to permit Mexican braceros to work on U.S. farms in the Southwest, and this agreement was expanded in 1943 to include non-agricultural workers.

Two years after the war ended, the governments of Mackenzie King and Harry Truman commenced private negotiations on a new Canada-U.S. free-trade agreement, an arrangement which at the time would have facilitated closer economic ties between the two most affluent nations on earth. The United States offered a large number of trade concessions, and in the era of the Marshall Plan and massive U.S. economic assistance to Western Europe and Japan, it is highly likely that the U.S. Senate would have ratified the pact.[8] The Canadian Prime Minister, who had initially given approval for the trade discussions in October 1947, vetoed the draft and the negotiations were ended in May 1948. Mackenzie King feared that the Canadian public would label the pact as continentalist and anti-British, and he was not prepared to face the political heat.

Through the multilateral process initiated by GATT, both nations agreed to trade liberalization in the post-war period. Trade flows north and south were enhanced, with an important boost provided by the Defence Production Sharing Agreement of 1958 and the Canadian-U.S. Automotive Trade Agreement of 1965 (the Auto Pact). The former arrangement provides for cooperation in weapons development and production, whereas the latter agreement was signed by Lyndon Johnson and Lester Pearson in January 1965 and permits free trade in original equipment parts and vehicles.

In the Auto Pact in particular, Canada has been provided with certain safeguards and trade and investment guarantees. The impact of the Auto Pact on bilateral trade has also been immense. For example, in 1984, Canada's leading export to the United States was motor vehicles and parts, valued at 21.5 billion dollars (U.S.). Canada's second leading export was crude petroleum, estimated at 3.3 billion dollars. The leading U.S. export to Canada was also motor vehicles and parts, valued at 19.8 billion dollars. The second leading American export to Canada was industrial machinery, with an estimated worth of 5.0 billion dollars.[9]

The Era of the Third Option, FIRA, and the NEP

Even though bilateral trade volumes was increasing, trade-related irritants would eventually cause significant strains in relations between Ottawa and Washington. The Nixon Shock of 1971 placed a 10 per cent surcharge on all dutiable goods, and Canada was not exempted from the order. Because of such damaging U.S. government actions and Canada's great dependency on the U.S. market, the

Trudeau administration embraced the Third Option, Canada would need to embark on a program to diversify trade and investment links. In a short period of time, trade agreements were initiated with the European Community and with Japan. Unfortunately, the fruits of such agreements were never realized, and Canada became more dependent than ever before on export trade with the United States. In the early 1970s, Canada sent two-thirds of its exports to the United States, compared to more than three-quarters presently.

Officials in Washington reacted warily to a law passed in 1973 which created the Foreign Investment Review Agency (FIRA). Two years later, U.S. criticism grew more intense as Parliament passed legislation to "Canadianize" *Time* and *Reader's Digest*. The Canadian government also eliminated the tax write-offs for Canadian companies which advertised on U.S. television stations situated along the border. Moreover, the Canadian Radio-Television and Telecommunications Commission (CRTC) consistently pushed for its own domestic version of the Third Option, advocating far greater Canadian content in television and radio programming.

In retaliation for the Canadian policy towards advertising on U.S. border stations, Congress invoked for a time tax restrictions to discourage American groups from holding conventions in Canada, an action which cost Canadian businesses far more than the fees lost by a relatively small number of American TV stations. In February 1979, the U.S. government also took the controversial step of imposing a countervailing duty on the importation of Honeywell optical sensing systems produced in Canada, claiming that research and development for the product had been subsidized by the Canadian government. Canadian officials in turn complained that the U.S. government was involved in the subsidization of research and development to a far greater extent than the Canadian government. Ottawa also pointed out that trade barriers were being erected rather ominously at both federal and state governmental levels through the proliferation of "Buy American" laws.

The bilateral relationship deteriorated further in 1981 with the introduction by the Trudeau government of the National Energy Policy (NEP) and a strengthened FIRA. With the advent of the Reagan administration, John Holmes warned that Canadians "face not only competition with American industry but also an ideological confrontation with born-again free enterprise."[10] Stephen Clarkson added that the bilateral relationship was subject to topsy-turvy twists. He contended that in 1980 Canadians were viewed in Washington as the "heros of the Western world" for rescuing six U.S. diplomats from Iran, but only a year later, in the wake of the NEP and FIRA pronouncements, were caricatured in the U.S.A. "as the hordes of Genghis Khan descending from the north to plunder innocent

American enterprise."[11] And indeed, during the height of the investment controversy, U.S. publishing magnate Walter Annenberg took out a full-page advertisement in the *Washington Post* using as his headline, "Canada's Unfairness Doctrine."[12]

The Era of Sectoral and Comprehensive Free Trade

The bilateral economic relationship passed its crisis point in late 1982 or early 1983. Faced with serious economic problems linked to the worldwide recession, the Trudeau government relaxed its NEP and FIRA regulations. Business and trade expansion were to be major priorities during the last months of the Trudeau and Turner administration, and a trade document was released which surprisingly expressed Canada's willingness to explore sectoral free-trade arrangements with the United States.[13] For its part, the Reagan administration cooled down its rhetoric and reacted positively to the overture for informal trade discussions. These discussions on sectoral trade began in Washington in December of 1983.

Following the landslide victory of Brian Mulroney and his Conservative Party in 1984, the bilateral agenda eventually shifted away from the sectoral approach and toward an exploration of a comprehensive free-trade accord. Part of the reason for this shift was the difficulty faced by the two negotiating teams in "matching" sectors and accommodating regional concerns. For example, the Canadian team might propose a sector such as carbon steel for free-trade consideration, but the U.S. steel industry would oppose it. The U.S. team might then propose a free-trade candidate such as furniture, but its Canadian industrial counterpart would object. The Canadian team also faced some heat when its proposals seemed to favour Western Canada over the Central Canada or vice-versa.[14]

In September 1985, the Mulroney government formally committed itself to enter into comprehensive free-trade negotiations with the United States, and these negotiations commenced in May 1986.[15] The agenda-setting first phase of the discussions were concluded in September 1986, and lengthy item-by-item discussions are now under way. The big question which remains is whether these negotiations will suffer the same fate as the discussions of 1910-11 and 1947-48.

Canada-U.S. Free Trade: Lessons from History

What insights are provided in the evolution of Canada-U.S. trade negotiations during the twentieth century which might provide some guidance to the teams engaged in the current free-trade negotiations? The following are important points to consider:

1. From the 1950s through the 1980s, Canada has almost always been the party which initiated the free-trade discussions;
2. The United States has generally shown a fair amount of indifference towards such discussions, with the major exception being President Taft's personal interest in the 1911 pact;
3. In the two most important sets of bilateral trade discussions of the twentieth century (1911 and 1947), Canada had second thoughts about a bilateral free-trade pact and eventually terminated the negotiations;
4. The U.S. Senate has at times been a formidable obstacle standing in the way of closer economic ties between the two nations, as exemplified by its veto of the 1874 trade pact and the East Coast Fisheries Treaty in 1981;
5. Most progress on trade issues has been made through item-by-item agreements (agricultural machinery), sectoral arrangements (defence and the automobile sectors), or through the multilateral GATT channel (most noticeably in the area of lowering or eliminating tariff barriers). Efforts to reach comprehensive agreements (the 1911 Reciprocity episode) or multiple sectoral arrangements (1983-1985 discussions) have proven to be very difficult and have been politically disruptive in Canada;
6. In strictly economic terms, the 1911 and 1947-48 draft agreements indicate that the United States was willing to make more concessions than Canada in order to establish a freer-trade arrangement;
7. Statements made in the United States by people often far removed from the negotiating process have been useful "cannon fodder" for those groups in Canada opposed to a free-trade accord with the U.S.A. In particular, during the 1911 discussions, one is reminded of Speaker of the House Champ Clark's intemperate annexation remark and the proposal by an obscure New York representative to ask Great Britain for permission to proceed with annexation discussions with Canada. During the 1947-48 informal negotiations, one may remember the *Life* magazine article which supported the creation of a custom's union between the United States and Canada, an article which undoubtedly influenced Mackenzie King's views on the proposed bilateral trade pact.[16]

In view of some rather inane statements already made by some U.S. elected or appointed officials, one can certainly expect that more "cannon fodder" will be available to opponents of the current bilateral discussions.;

8. Those who oppose a free-trade accord in Canada generally have great difficulty in formulating convincing arguments which indicate that the economic costs of free trade outweigh the potential economic benefits. On the other hand, they can make appeals to emotionalism, loyalty, nationalism, and general love of country which tend to have far more powerful gut-level impact on the average Canadian than strictly economic arguments.

   For example, in 1911 Robert Borden and his Conservative compatriots were very effective in using such slogans as the following: "Let Well Enough Alone," "A Vote for Borden is a vote for King and Flag and Country," "Empire or Continent, Which?" In addition, Borden's followers denounced "the treason that barters our birthright for the gold of the Kings of the South."[17] In 1948, Mackenzie King worried about the criticism which would be heaped upon him if he accepted the proposed bilateral agreement. He lamented that Canadians would consider him as pro-continentalist, anti-British, and a stooge of U.S. financial interests.[18]

   Today, neither the Liberals nor the NDP has come up with persuasive economic arguments opposing a free-trade pact, and indeed both parties support sectoral trade discussions with the United States. On the other hand, their emotive appeal in opposition to free trade are certainly having a significant impact on the hearts and minds of many Canadians;

9. In 1911, the negotiations from the U.S. side were orchestrated from the White House, whereas in 1947-48 the State Department assumed the dominant role. Eventually, Congress tired of what it perceived as the State Department relegating U.S. economic and commercial interests to the second tier in favour of diplomatic interests with various nations. Consequently, the Department of State was stripped of its lead role in such negotiations.

   Today, the Office of the U.S. Trade Representative (USTR) is in charge of the discussions with Canada. With Congress watching over its shoulder, and with a host of business-dominated Advisory Groups providing guidance, USTR is expected to focus on pragmatic commercial and economic issues, and much less on the overall diplomatic-political importance of the bilateral relationship. Consequently, Canadian concerns about cultural issues, regional economic development, social welfare programs, and overall sovereignty may be treated with somewhat more skepticism than if the State Department were heading the discussions. In effect, USTR is much more likely to view each issue through the lenses of the U.S. business community, and not through the lenses of the diplomatic community which would certainly be more sensitive to Canada's concerns about the important non-commercial issues;

10. When economic times get tough, Canada usually attempts to improve its access to American markets, whereas the United States tends to turn inward and to become much more protectionist in its trade policies.

Certainly, the Canadian tendency to initiate discussions and then to have second thoughts about free-trade arrangements has the most important implications for the current negotiations. Many Canadians continue to fear that a free-trade arrangement with the United States would limit Canadian sovereignty and facilitate closer economic and political integration. This apprehensions may well be the chief stumbling block to the conclusion of a comprehensive free-trade accord. In effect, Ottawa tends to initiate trade discussions with Washington during times of economic malaise, and then backs off once a pact has been negotiated (specifically 1911 and 1948).

U.S. indifference could provide the Conservative government with an easy excuse either to exit prematurely from the talks or to arrange a modest accord. Certainly, Ronald Reagan would like to see some sort of pact signed between Washington and Ottawa, but in 1987 he is a lame-duck President preoccupied with putting out major political fires at home. The U.S. negotiating team directed by Peter Murphy has not been pressured by the Reagan administration to secure a comprehensive trade accord. Indeed, the U.S. side is content to have Simon Reisman's group initiate most of the agenda items.

Will the U.S. Senate prove to be a nemesis if Reagan and Mulroney do reach an agreement? The U.S. constitution stipulates that the Senate must approve any treaty by a two-thirds majority. In order to gain the necessary 67 votes in the Senate, Jimmy Carter had to make major concessions to Senate conservatives and moderates before garnering enough support to ratify the Panama Canal treaties. Canadians also remember with less than fond memories what a group of New England senators was able to do to the Fisheries Treaty. Could the same problems arise with a Canadian-U.S. free-trade pact?

It is certainly possible, but not likely. The new fast-track system which is in place greatly increases the chances that the U.S. Congress will approve any pact negotiated by the neighbouring governments, in spite of the fact that protectionism is on the rise, and the Republicans control the White House whereas the Democrats control both houses of Congress. For one thing, the pact will not be formal treaty and thus will not require a two-thirds vote in the Senate. Instead, both the Senate and House of Representatives will be asked to provide majority support for the proposal. In addition, fast-track rules insure that neither chamber will be able to attach amendments to the legislation. The senators and representatives will face a simple take-it-or-leave-it vote, even if the proposal tends to be somewhat asymmetrical with the U.S. making more economic concessions than Canada. If an agreement can be reached by January 3, 1988, the U.S. Congress will have 60 legislative days to accept or reject the pact. This fast-track system was first used bilaterally with the U.S.-Israeli free-trade accord implemented in 1985 and greatly simplifies the congressional ratification process.

The historical lessons to be learned from how the two nations react to economic downturns should also be taken to heart by the trade negotiators. When economic conditions deteriorate, the United States tends to turn inward, whereas Canada looks for greater access to the U.S. market in order to spur on economic development and the creation of new jobs. The United States may now be facing some of the most difficult economic challenges in its history, and protectionist sentiments, particularly in those regions with traditional manufacturing or resource-based industries, are growing dramatically. Without a fairly comprehensive free-trade accord, and in light of past difficulties faced in trying to patch together sectoral arrangements, will Canada risk losing some of its access to the U.S. marketplace? The answer is definitely yes, and the risk is not just linked to new export activity. Rather, in the face of mounting protectionism in Washington, the most ominous risk may be loss of U.S. markets already captured by Canadian firms.

Notes

1. In 1874, a draft treaty was finally negotiated which would provide free trade in steel, paper, shoes, furniture and other wood products, agricultural implements, and a broad range of manufactured goods. The British government, on behalf of Canada, gave its approval to the accord, but the U.S. Senate refused to ratify the pact sent to it by the Grant administration.

2. See Richard Gwyn, *The 49th Paradox* (Toronto: McClelland and Stewart, 1985), pp. 36-37.

3. Two good sources of information on the 1911 episode are Edelgard E. Mahant and Graeme S. Mount, *An Introduction to Canadian-American Relations* (Toronto: Methuen, 1984), pp. 92-98, and Lawrence Martin, *The Presidents and the Prime Ministers* (Toronto: Doubleday Canada, 1982). In particular, Martin gives an excellent account of the Laurier-Taft-Champ Clark reciprocity battle.

4. See Carl Wittke, *A History of Canada* (New York: Alfred A. Knopf, 1928), pp. 264-271.

5. See Congressional Quarterly, *Trade: U.S. Policy Since 1945* (Washington, D.C.: Congressional Quarterly, 1984), p. 40.

6. Quoted in Gwyn, p. 50.

7. The U.S. had actually removed duties on farm machinery in 1913, with Canada following suit in 1944.

8. The draft outline of the free-trade pact is found in Gwyn, pp. 337-340.

9. *Barron's*, November 18, 1985.

10. John W. Holmes, *Life with Uncle: The Canadian-American Relationship* (Toronto: University of Toronto Press, 1981), p. 60.

11. Stephen Clarkson, *Canada and the Reagan Challenge: Crisis in the Canadian-American Relationship* (Toronto: Canadian Institute for Economic Policy, 1982), p. 28.

12. This episode is discussed in *Maclean's*, October 25, 1982, p. 38.

13. Government of Canada, Department of External Affairs, *Canadian Trade Policy for the 1980s: A Discussion Paper* (Ottawa: Minister of Supply and Services, 1983).

14. As a Special Assistant in the Office of the U.S. Trade Representative during this period, I had the opportunity to participate in some of these bilateral meetings.

15. For a look at the Mulroney government's initial trade position, see Government of Canada, Department of External Affairs, *Canadian Trade Negotiations: Introduction, Selected Documents, Further Readings* (Ottawa: Minister of Supply and Services, 1986).

16. See R.D. Cuff and J.L. Granatstein, *American Dollars – Canadian Prosperity* (Toronto: Samuel-Stevens, 1978), p. 77. The *Life* magazine article appeared in the March 15, 1948 edition.

17. Wittke, pp. 268-269.

18. Cuff and Granatstein, pp. 78-82.

Canada's Foreign Policy in Search of a Fourth Option: Continuity and Change in Orientation Towards the United States[1]

P. Soldatos

The Concept and the Origin of the Diversification Orientation

Diversification, as a reaction to the pressures of the international environment through the search for substitution links and countervailing relations, has appeared regularly in the discourse and behaviour of Canadian policy-makers, in some cases even before Confederation. The establishment of reciprocal limited free trade between Canadian Colonies in 1849 and the Reciprocity Treaty with the U.S., in 1854, represent the diversification reaction of British North America, responding with policies of partial substitution to the imperial-preferences-dismantling process of the 1840s, as undertaken by Great Britain. The Canadian Confederation and its subsequent "National Policy" of a horizontal economic integration also looked for a "domestic" diversification answer after the end of the Reciprocity Treaty and in view of Canada's foreign trade difficulties.

In the context of Canada's foreign policy, diversification is based on the idea that it is advantageous to provide a state with a large number of partners and a vast set of relations of a quantitative (volume of relations) and qualitative (areas and types of interaction) importance. It seeks to avoid exclusive, dependent relationships. The Canadian philosophy of diversification, based often on economic, political and cultural considerations, was, in the 1970s, a reactive policy of partial counterweight, mainly in the sphere of economics and culture, looking for a polygonal relationship with various foreign regions and countries, in order to reduce Canadian dependence on the U.S.

The Third Option, Cornerstone of Canada's Foreign Policy of Diversification in the Years 1972-1983

The Third Option constitutes the cornerstone of the diversification process of the period 1972-1983, and the stem on which were grafted, progressively, the various elements of the Option's updating. As we shall see, the Third Option refers directly to the 1970 Government White Paper's main foreign policy objectives, that strive, by the appropriate domestic and international policies, to reduce Canada's vulnerability *vis-à-vis* the external environment, and in particular the U.S. It reflects a new impetus, after the review process of 1968-1970, insofar as it transposes the philosophy of diversification to the level of strategies and policies; it completes the revision of 1968-1970, by adding to it the scope of Canadian-American relations, and introduces new considerations on the evolution of Canada and of the international system at the beginning of the 1970s; it has remained, since 1972, the most fundamental and systematic approach to Canada's foreign policy adjustments, a framework into which were placed, later, some other elements of foreign policy (selective international regional policies, policies of bilateralism, etc.).

As a *foreign policy option*, the Third Option, reflecting a philosophy of diversification, indicates a choice of "containment", in view of the strong continentalist integrative North American forces penetrating the Canadian system (in the sphere of the economy, culture, communications, decision-making process, etc.). As an *objective*, the Third Option contains a double goal: an *intermediate* one, the reduction of Canada's vulnerability, *vis-à-vis* the U.S. influence; and an *ultimate* one, the promotion of the major Canadian foreign objectives, while preserving a Canadian national identity.[2]

This "double" objective demonstrates the will to pursue, *interdependently*, the main aims of the 1970 "White Paper".[3] Indeed, where the "White Paper" lists three priority objectives, those of economic growth, social justice and quality of life, and subsequent Government declarations insist on the primacy of economic growth, the 1972 Third Option document advocates the need to "reinforce the economy", but also the "other aspects of national life" and the "promotion of the major Canadian objectives in accordance with the need to preserve the Canadian national identity";[4] thus, it integrates in the same policy of diversification the objectives of the 1970 "White Paper"[5] and re-emphasizes, in a new continuum of priorities, cultural and political goals.

It follows, from the Third Option perspective and its diversification substratum, that Canada should aim at a stimulation of economic growth (increased productivity, broadened trade, more dynamic investment abroad, etc.), without, however, jeopardizing the quality of life (cultural dynamism, bilingual and multicultural personality, etc.), and the parameters of social justice, and without neglecting the preservation of a harmonious environment (e.g. more parsimonious use of our natural resources) or hurting national sovereignty and independence (need for reduction of American control on Canadian industry and natural resources, promotion of national personality, etc.). In summary, in 1972, Canada decided to temper the importance of economic determinism on Canadian foreign policy orientations in order to make way for more cultural and political determinism. Thus, the rejection, in 1972, as in the past, of the Second Option – free-trade or customs union with the U.S. – was because of the belief that "it could harm Canada's independence and not because it was economically unsound with relation to the need to improve Canada's living standards and the economy's stability".[6]

As to the relationship of the Third Option to diversification, it presents a double dimension, needed to be outlined here. In effect, as a philosophy of counterweight and as a basic orientation of Canadian foreign policy, diversification constitutes a major inspiration for the Third Option and its fundamental orientation, as well as one of its main avenues of implementation.

The Fourth Option of the Eighties: The Thesis of Compatibility between Diversification and Free Trade Continentalism

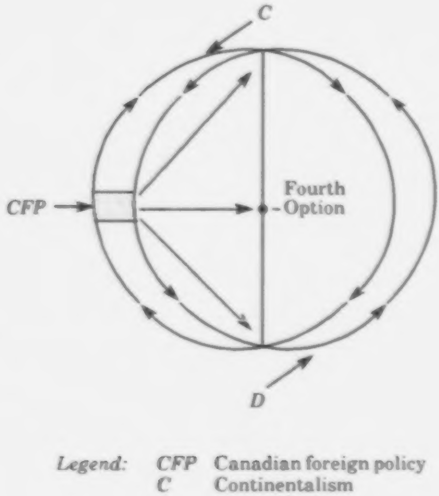
In the 1970s, a clear distinction was generally drawn in the specialized literature and in the discourse of decision-makers between continentalist policies and diversification policies, while not enough attention was paid to areas where the two might overlap and interact. Today, however, the very high degree of transnationalism in foreign relations has resulted in a situation where, under certain conditions, continentalism is beginning to appear as a springboard to diversification and vice versa.[7]

Indeed, some observers are beginning to think that there are areas where, in certain circumstances (for example, the adoption of a true *World Product Mandates* formula),[8] greater Canada-U.S. cooperation, perhaps even a certain degree of integration in such areas of specialization, modernization, technology transfers, etc., would strengthen the Canadian economy in its attempts to penetrate the markets of other countries and to redeploy Canadian capital on a broader international basis through continentalist alliances with

American capital. Also, they think that one should not overlook the fact that some diversification operations, particularly though transnational cooperation, could reinforce the Canadian economy and increase its weight in the Canada-U.S. continentalist relationship; such operations could give Canada and its partners in diversification a stronger presence on the American subcontinent.

Government publications, both under the Liberals and the Conservatives (e.g. *A Review of Canadian Trade Policy* (1983) and *A New Direction for Canada* (1984)), are moving in the direction of compatibility between the Second Option and the Third Option. Figure I illustrates this concept of Compatibility between continentalism and diversification. In the language of Canadian foreign policy of the 1970s, this could be called a Fourth Option, which combines the two options of Mitchell Sharp's 1972 document, namely the Second and Third.

Figure I:
Relationship Between Continentalism and Diversification in Canada's Foreign Policy for the Eighties



Legend: *CFP* Canadian foreign policy
C Continentalism
D Diversification

In Figure I the diameter and the direction of the arrows indicate a cyclical relationship and synthesis between the options of continentalism and diversification, such that the adoption of one option is a springboard to the other. According to the arrows, one passes from continentalism to diversification, and vice versa, since the concentric circles of continentalism (C) and diversification (D) have their points of intersection.

There could be however, a number of difficulties in pursuing this Fourth Option:

1. It could raise questions about the effectiveness of our diversification policy in some of our extracontinental partners,such as Europe and Japan, as well as within the various segments of Canadian society (e.g. the public sector, the private sector, academic circles, and the mass media), creating some doubts as to our willingness to diversify.
2. It could reinforce the effects of the Second Option rather than those of the Third Option, because of the current importance of the transnational and transregional continental reality, and, thus, it could not be able to maintain the equilibrium between the two.
3. The diversification that might result from the Fourth Option would be closer to diversification of a North American economy (of Canada and the United States) than of a Canadian economy that wishes to diversify in order to differentiate itself from that of the United States.

To sum up, starting from a Fourth Option, the shift toward some Second Option effects would, in large part, bring the debate on the Fourth Option back to the continentalist reality, with its advantages and disadvantages.

The Notion of Continentalism in the Context of Canadian-U.S. Relations

The concept of continentalism, seen in the context of contemporary Canadian-U.S. relations, means a process of microregional (subcontinental) integration. Such a process has already begun with the transnational (involving multinational corporations, unions, economic elites, etc.) and transgovernmental (involving direct contacts between the two central bureaucracies or relations at the level of the provinces and the American states) relations, and has led to closer Canada-U.S. transactional ties (diplomatic, administrative, commercial, cultural, communications, etc.) and to structural interpenetration (particularly economic). It did not, however, produce an intergovernmental, comprehensive free trade agreement between the two countries that stands at the lower end of the integration continuum of the various institutional forms of international regional integration (free trade, customs union, common market, monetary union, economic union).

First implemented, although only partially, through the Reciprocity Treaty of 1854, the free trade option was supported, since the last century, by some Canadians because of its numerous, mainly economic benefits, and rejected by others who saw it as the beginning of a process of assimilation into the American system.

This difference of opinion concerning the free trade option in the context of Canadian-United States relations has often been obscured by politicized discussions about the option's real merits and weaknesses. Canadians have never been able, for example, to examine the option of closer economic ties with the U.S., through free trade, in a purely economic perspective. Social, cultural and political considerations have always intervened as basic orientation and decision variables.

Born of colonial determinism, Canada was, from the outset, torn between different and contradictory systems of political values: the republican spirit, conservatism and the Empire, and nationalist ideology, all exercised their attractions on various segments of Canadian society. Having no other regional options for international economic integration than that of an asymmetric partnership with the United States, Canada hesitated between the rational continentalist route of economic development and its own aspirations to an autonomous development. Many Canadian leaders were uncertain as to the effects of the relational and structural differences in size between the two partners in the free trade adventure. In addition to these reasons, real or perceived, to these fears and hesitations, there are inherent weaknesses of approach in Canadians' scientific understanding of the results of the free trade process for a number of reasons: the economic consequences of that process could be unevenly distributed over the various regions and segments of Canadian society; its socio-cultural and political impact does not lend itself easily to quantification and cannot be measured with a highly rigorous methodology; its process-like nature does not enable us to perceive all the variables of the related integration phenomena and all the stages in its implementation through time.

The Reasons for the Current Renewed Debate on Free Trade Continentalism

The continentalist question has never completely disappeared – as an option or as a danger, depending on the period and the actors concerned – from the Canadian societal debate, and was reinserted in the Canadian foreign policy orientation process in the early 1970s. As we mentioned, however, it was quickly rejected as an option, in 1972, by our decision makers – more for reasons of political and cultural protectionism and of nationalism than through any careful examination of the economic reasons – in favour of a policy of diversification, the basis of the 1972 Third Option. Since that time, it has often reappeared in various proposals, from both sides of the border (but mainly Canada), suggesting closer ties between Canada and the United States through such means as greater cooperation, free trade, a general or an energy common market, and, to a marginal extent, an economic union.[9] Lastly, Canadian free trade ideas in recent years[10] have renewed the continentalist debate by providing more specific implementation perspectives.[11]

Without claiming to provide an exhaustive list, we would suggest the following as reasons for this resurgence of free trade continentalist ideas in the eighties: (1) tariff liberalization measures, following the GATT negotiations; (2) the persistence, during the 1970s, of a very high volume of trade with the United States and its considerable increase in the 1980s; (3) obstacles to the implementation of the Third Option and the meagre results of Canada's efforts for diversification; (4) difficulties within GATT in reducing and eliminating non-tariff barriers, accompanied by a new protectionism in the U.S. Congress; (5) the crisis in the economies of partners in the industrialized world, in particular in Europe, massive debts of Third World and Eastern countries, the crisis in East-West relations; (6) pressures brought to bear by various Canadian elites in favour of the Second Option (continentalism); (7) a softening of Canada's economic nationalism at the level of public opinion; (8) the need to restructure the Canadian economy to remain an advanced industrial society; (9) the idea that continentalism is not necessarily the opposite of diversification; (10) the Canadian government reorganization, whereby the institutional component of foreign trade was added to the Department of External Affairs; (11) the development of transborder or transregional forms of continentalism among provinces and U.S. states; and (12) the positive experience of limited trade continentalism.

The Foreign Policy Debate on Canadian-U.S. Free Trade: The Central Issue of "Spill-over"

The possibility that a "spill-over" process, which could lead a Canada-U.S. free trade area toward more advanced forms of economic integration, and might also in the longer run, bring about forms of political and cultural integration has long been a central argument against a foreign policy of free trade continentalism.

In general, "spill-over" refers to an evolutionary process of a form of international regional integration over its entire integration continuum, i.e. free trade area; customs union; common market;

Table I
Canada-U.S. Free Trade Continentalism and its Insertion in Canadian Foreign Policy

I Environment	II Major National * Aims	III Major National * Objectives - 1970	IV Policy Options Related to Major National ** Objectives - 1972
Internal environment (political, strategic-military, economic, cultural) External environment (political, strategic-military, economic, cultural) Regional (American sub-continent) global (global international system and sub-systems)	• Canada must safeguard its political independence • Canada and all Canadians must enjoy general and increasing prosperity • All Canadians must find values worth preserving in their lives and relations with other people	• Stimulate economic growth in Canada • Promote social justice • Improve the quality of life • Preserve Canada's sovereignty and independence • Work for peace and security • Maintain harmony in the natural environment	• *First Option* (rejected) Canada may seek to maintain its relations with the United States in more or less their current state, modifying its policies as little as possible (status quo) • *Second Option* (rejected) Canada may move deliberately toward greater integration with the United States (continentalism) • *Third Option* (adopted) Canada may adopt a general, long-term strategy to develop and strengthen its economy and other aspects of its national life, thus reducing Canada's current vulnerability (diversification)

* 1970 White Paper

** 1972 Document on Third Option

Table I (continued)

V Some Determining factors in the Current Renewed Debate Surrounding Free Trade Continentalism in the 1980s	VI Some Sectorial and Intersectorial Options for implementing Continentalism	VII Some Approaches (Successive of Simultaneous) in Favour of Continentalism
• Tariff liberalization within GATT • Existence of an advanced process of transgovernmental, transnational and infrastructural continentalism in Canada-United States relations • Existence of regional forms of continentalism (transborder or transregional) • Canadian need to remove American non-tariff barriers (GATT's weaknesses in this area) • Difficulties in the process of implementing Canadian diversification policies • State of public opinion and that of Canadian elites • Needs with respect to the Canadian economic reorganization process • Possibility of using continentalism as a springboard to diversification • Existing experiments in sectorial Canada-United States free trade • Certain American difficulties on the world scene (economic, political, etc.)	• Second Option (economic continentalism) · Canada-United States free trade agreement (comprehensive, multisectoral, sectoral) · World Product mandates • *Other continentalist options already eliminated:* · Canada-United States-Mexico common energy market · Common market (bilateral or trilateral with Mexico) · Economic union	• Bilateralism · asymmetrical · institutionalized • Regionalism • Transnationalism • Transgovernmentalism

monetary union; partial economic union; full economic union; political union stemming from full economic union.

The Opponents of Free Trade and their "Spill-over" Hypothesis

Among opponents of free trade, the most representative arguments may be found in Mitchell Sharp's 1972 document "Canada-U.S. Relations: Options for the Future". It was, in fact, the hypothesis of economic, political and cultural spill-over that led to the 1972 rejection of the "Second Option" as a possible alternative for our foreign policy towards the United States (despite the fact that it could be rational in terms of economic benefits).

Having a free trade integration and, later, joint economic policies would require a number of common institutions and, thus, lead to a loss of decision-making autonomy (which, in itself, is a process of political integration). Institutional and decision-making integration and economic integration would deprive Canada of autonomous policy powers, thus leading towards political integration.

The Position Rejecting the Spill-over Thesis

The most typical statement of this type of argument is the position put forward by Canada's Senate Standing Committee on Foreign Affairs, which, in 1982,[12] reiterated or reformulated some of its own earlier arguments or those of others (e.g. Peyton Lyon's).[13]

The Senate Committee rejected the claim that a Canada-United States free trade agreement would produce substantial economic and political spill-over. The schematic presentation of the hypothesis discounting the possibility of spill-over could be summarized in the following way:

1. Canadian-U.S. free trade involves only a limited harmonization of economic policies, thus does not lead to economic integration (or political integration).
2. Canadian-U.S. free trade would not reduce Canada's independence in foreign policy; in fact it might increase it.
3. Canadian-U.S. free trade would protect Canada from U.S. non-tariff barriers and, for that matter, from departure of Canadian firms south of the border.
4. Canadian-U.S. free trade would not lead to political integration with the United States: it would strengthen the Canadian economy, thus increasing the confidence of Canadians and their capacity to withstand the attractions of the U.S. and to protect their political independence.

A schematic presentation of arguments underlying this rejection of the possibility of spill-over (arguments which are not all presented in the Senate's document) are to be summarized as follows:

1. Comparisons to the experience of other international associations (free trade areas, customs unions, common markets, etc.): the EFTA, the former trade agreement between Great Britain and Ireland and the New Zealand-Australia free trade area have not, according to this thesis led to economic spill-over, and the EEC is still far from the economic and political union initially envisioned.
2. An argument based on the fact that certain forms of contemporary continentalism, that are already found in Canada-U.S. relations (interpenetration in terms of American investment, ownership and control over Canada's resources and economy, trade concentration, etc.), have not led to increased economic integration involving common socio-economic policies, or to cultural or political integration.
3. An argument based on the hope for increased and more harmonious (across the Provinces) Canadian economic development, following a free trade prosperity, likely to strengthen Canada's horizontal cohesiveness as well as its economic, cultural and political independence and its international importance.
4. An argument based on the idea that continentalist pressures could take the form of a serious threat to Canada and thus exacerbate national defensive feelings.
5. Canada after the Québec referendum and the patriation of the Constitution, is, politically, a more "mature" federation, with considerable progress in the "nation building process".

Our Thesis on the Spill-over Question

The main features distinguishing the Canada-U.S. situation from that of other free trade areas, among industrialized countries, are summarized here as follows:

First of all, there is a very high integrative potential in the Canada-U.S. relationship which does not exist to the same extent and intensity in other areas: Canada and the United States have become so similar as societies over the years (through concentrated transnational and transgovernmental relations, through increasingly similar attitudes and values, intense social communications, strong socialization factors, and deeply rooted structural economic interpenetration), that free trade would be following an already widespread integration pattern (in other examples of free trade integration, the prior integrative potential has been much lower).

Another difference is that the *bilateral North American system* is less deeply penetrated by the international system and by its subsystems than are the other regional systems.

Third, there is the fact that the U.S. is a superpower (diplomatically, strategically, socio-economically); this accentuates the uniqueness of the Canada-U.S. situation. In other areas, the asymmetry of power has not been so pronounced or so multidimensional.

A fourth feature is geographical contiguity and the absence of a natural boundary over large parts of the border separating the two countries, as well as the proximity of most of Canada's population to this border. This brings Canada closer to the development centres and activities located south of the border (e.g., the head offices of multinationals, buying and selling markets, population centres, communications lines, etc.). In other integration areas, such as England and Ireland, the EEC, the EFTA countries, the New Zealand-Australia zone, natural boundaries and distance provide clear borders – in terms of objective social communications and transactions, as well as in terms of subjective perceptions and images.

Then, there is the fact that the nation-building process is somehow incomplete in Canada, with all the attendant attitudinal, political, institutional and economic fragmentation that this involves. This stands out in contrast to the more integrated systems which are partners in free trade areas involving industrialized countries.

Furthermore, the dyadic nature (including both asymmetry and structural interpenetration) of a CUFTA (Canada-U.S. Free Trade Area) decreases the relevance of the comparison, e.g. with EFTA.

Finally, the absence for Canada of real solutions to an alternative regional integration adds to CUFTA's distinctive characteristics.

These differences should not be examined in isolation; rather, they should be considered as a whole, since the ways they interact and their possible cumulative effects tend to emphasize still further the uniqueness of the Canadian-U.S. situation and to suggest possibilities of spill-over.

The Need for Corrective Measures

Negative integration (free trade zone), which eliminates trade barriers in the trade of goods and, in some cases, barriers to the movement of some factors of production (e.g. capital), generates disturbances and distortions in a country's economy, especially if there is economic asymmetry within the partners' respective societies (regional imbalances, for example) and between the partners (asymmetry in development and distribution of factors of production, structural and relational asymmetry as evidenced in the interaction of the economies of the member countries, etc.). For, in effect, the partial or total freeing up of the circulation of goods and, in more advanced integration, of the movement of the factors of production, reinforces the initial development imbalances and causes economic distortions whose socio-economic and political impact would call for joint corrective action (spill-over towards positive integration) or, if there is no consensus for integration, would lead to the adoption of national measures that could compromise the free trade arrangement itself ("spill-back").

Thus, if there is asymmetry between the partners, negative integration is forced to go forward, simply to avoid going backward, and some spill-over towards positive integration must be accepted if the arrangement is not to disintegrate through national unilateral actions.

The concept of corrective spill-over resembles the neo-functionalists' idea of functional linkage of tasks. Each new integration phase (through spill-over) is considered as the answer to the problems of the immediately preceding phase, and as a desirable or necessary complement to previous integration measures.

Towards an Overall Evaluation of the Likelihood of Spill-over in the Proposed Canada-United States Free Trade Area

In Table II, we are proposing an evaluation of the spill-over likelihood. It nonetheless goes without saying that it is not clear that all the variables given in Table II need to be present for spill-over to occur or, for that event if they are, they would suffice for spill-over to occur.

First of all, a quantitatively and qualitatively significant initial integrative potential links the two countries. In fact, the generally "average to high" integrative conditions that mark Canada-U.S. relations and leave open the possibility of free trade integrative arrangements could, if they were (as it seems likely) to continue after a free trade integration, become conditions for the development of further integration and, hence, for the spill-over.

The process of deideologization and depoliticization that advanced industrial societies are going through, accompanied by economic and technological determinism on the one hand and technocratic and bureaucratic legitimacy on the other, could foster a spill-over, involving rationalization of relationships. However, in view of the enormous domestic and international power of the United States, the fears, in Canada, of political integration and the accompanying nationalistic feelings often cause American and Canadian leaders to take politicized positions in their bilateral

Table II
Overall Evaluation of Probability of Integrative Spill-over in the Eventuality of Canada-United States Free-Trade (favourable conditions)

Conditions favourable to spill-over	Evaluation of each condition
1. Presence, continuance and development of initial quantitatively and qualitatively significant integrative conditions	average-high
2. Predominance in both member countries of a bureaucratic model	average
3. Increased development of transnational and transgovernmental relations	high
4. The CUFTA reaches a ceiling	high
5. Operating irregularities, trade distortions, economic disturbances, and unequal distribution of benefits in the free trade area suggesting corrective measures	high
6. Absence or discounting of alternative solutions	average-high
7. Externalization of the process	low-average
8. Continuity between matters of high politics and low politics	low
9. Establishment at the outset of strong common institutions or need and desire to do so later	low
10. Political will for cultivated spill-over (mainly the wish of the elites, but also the masses)	low

relations (see for example the stances taken by leaders like Diefenbaker and Trudeau on some domestic and international matters); in certain instances, these leaders even play the role of "dramatic-political" actors, (without identifying themselves with it completely or permanently), thus producing the "average" evaluation found in the Table (it is an overall evaluation, whose intensity cannot be rated any more accurately).

A major transnationalization of Canada-U.S. relations (companies, unions, etc.) could lead to an integration spill-over. Intra-firm relations, for example, usually avoid governments politicization and establish strong integrative infrastructures which draw Canada increasingly into the North-South orbit. The same applies also to Provincial-State transregional relations. The evaluation of this variable for the Canada-U.S. situation appears to be high.

As comparative experience in international integration shows, free trade areas have a great deal of difficulty in broadening their field of integration. A Canada-U.S. free trade area would be caught up in intergovernmental inertia, exposed to unilateral intervention by one or other of the partners, struggling with the question of non-tariff barriers, or trade diversion, unable to deal with the problem of asymmetrical distribution of the benefits of integration (annoying the United States in cases of Canadian protectionism and annoying Canada by its economic distortions) fragmented in its interaction with the international environment (in the absence of a customs union). Would it show signs of running out of steam and reaching a ceiling in terms of utility, to the point that it would have to choose between disintegrating stagnation and developmental spill-over? The example of NAFTA, which spilled over into the new 1983 ANZCERTA agreement, extending free trade and tightening economic links between the two countries, is conclusive. The same is true of EFTA's need to evolve: its members sought change through membership in European Communities or through a free trade association with them. Thus, this condition seems to be high.

As we have already mentioned, asymmetry between the partners in Canada-U.S. free trade arrangement and disturbances from the "free flow" would strongly call for corrective and complementary measures for the area, if unilateral action with disintegrative effects is to be prevented.

Modernizing, specializing and remodeling the Canadian economy within a framework of economies of scale in a free trade area of two partners, dissatisfaction of other countries with such regional protectionism, the difficulties of Canada's Third Option Policy, and the adoption of a continentalist policy, would cause Canadians to have strong feelings of irreversibility; the absence of alternative solutions would lead to greater acceptance of continentalist integrative logic and therefore to an inability to hold back the spill-over. We, however, evaluated this variable as "average-high" rather than "high", because the lack of alternative solutions is of more concern to Canada than to the United States, since less restructuring of the latter's economy would be required by free trade and their choices as an international superpower would be less compromised.

The need to respond to criticisms and requests for arrangements from other countries faced with this regional free trade arrangement, to contribute in a coordinated manner to the multilateral debate on trade liberalization, to ensure, through common trade policies, clear benefits in the market of the other partner *vis-à-vis* other countries, as well as the increased internationalization of the economies of advanced industrialized societies and the development of the world economy, are all conditions suggesting a need for externalization of the Canada-U.S. free trade area, which could cause a spill-over towards a customs union and common trade policies. However, our evaluation of the variable as "low-average" is due to probable American but perhaps also Canadian reticence towards common policies.

The continuity between matters of "high politics" and matters of "low politics" is, by no means, certain in the Canada-U.S. situation (low). The desire to maintain Canada's cultural and political identity, the heightening of Canadian's historical and political awareness of the risks of political absorption, the elements of fragmentation in the Canadian federal system, the strength of the United States as a superpower, and the desire of Americans to keep a free hand in the sphere of diplomacy and strategy, all reduce this continuity to a low level. Henceforth, the area's political spill-over could not be the easy result of a functional linkage of tasks, but rather of a long process of economic integration.

At the institutional level, it has been observed that strong common institutions can be a driving force towards integrative spill-over. Speaking of the establishment of the supranational European Community system, "the institutional first, the economy and political integration later" was the byword. We believe however, that the institutions of a Canada-U.S. free trade area would, most likely, be weak, i.e. intergovernmental, which would not favour a progression towards more integration.

The political will (of both elites and masses) needed for the political spill-over does not appear to us to be present in the current context of Canada-U.S. free trade. On the Canadian side especially, there is strong opposition to the idea of political integration with the United States.

As for what overall conclusions are to be drawn from the Table II, we see a potential for integrative spill-over, with three conditions of high intensity, two average-high, one average, one low-average, and only three low. Even though the high or average variables are primarily in the economic area (economic spill-over), one cannot exclude the possibility of dynamic linkages towards decision-making, institutional and political spill-over for common, corrective and complementary free trade economic policies, that could call for abandoning certain sovereign powers of unilateral action. The main variables that would restrain this political spill-over are the variables 8, 9, and 10.

Finally, we wish to add that a spill-over process does not exclude crisis situations, which could, indeed, contribute to further integration. To recall what E.B. Haas said on the subject, if it is true that "the process of spill-over from economic integration will not only lead to *gradual politization*, but also to occasional crises",[15] it is also true that these crises are "the creative opportunity for realizing the potential to redefine aims at a higher level of consensus".[16]

The Foreign Policy Debate: Some Elements of Orientation

It is impossible to grasp the essence and complexity of the free trade option without placing it in the context of the historical, political, sociocultural, economic, and geographical environment that explains Canada's hesitancy about forming a free trade area with the United States. We have always found it difficult to give up our transatlantic diversification links and certain elements of national identity in order to establish continentalist ties; however, it is becoming increasingly doubtful that diversification will be able to provide for Canada's market needs or for its economic restructuring during these last two decades of the century.

The attitudes and decisions relating to free trade option in North America were determined in the 1970s by considerations which, partly, avoided the economic and technological determinism of our times, interposing a cultural and political dimension.

Canada is constantly being pulled along in the wake of continentalism, since it is the only advanced industrial society that does not have an internal demographic market reservoir, or a multilateral or bilateral (but symmetrical and diversified) regional integration framework.

Limited continentalism started with the Liberals in 1983. In the present decade, a number of factors are combined and make it increasingly difficult for Canada to resist the free trade continentalist option. These factors include protectionist moves in the U.S., using non-tariff barriers, Canada's acceptance of GATT's reduction of tariffs, Canada's existing involvement in transnational and transregional continentalism, its awareness of the serious limits to its efforts for diversification and its need to restructure its economy.

In considering the economic imperative pushing Canada towards free trade, we should not exclude, under some conditions, a certain continentalist springboard to diversification (reinforcement, through cooperation with the United States, of the international importance of our economy); on the other hand, through a feedback phenomenon, Canada could profit from a diversification success and be competitive in a North American free trade.

Some Orientations on Spill-over

The approach of spill-over proposed in this study is based on an eclectic view, taking into account the dirigist an neofunctionalist approaches. A Canada-U.S. free trade area could produce an economic spill-over, which could lead to a certain amount of political spill-over. Nevertheless, the low level of initial integration in a free trade area would reduce the extent of an integrative spill-over. The movement from negative integration (free trade area) to positive integration (customs union, common market, etc.) is more difficult: The continuity between issues of "low politics" and issues of "high politics" is not assured; the absence of strong common CUFTA institutions, together with the lack of political will for more integration, would limit the degree of political spill-over.

Notes

1. This paper draws heavily on two of our previous studies: P. Soldatos, Free Trade Continentalism in Canada-U.S. Relations, in J. Quinn, ed., *The International Legal Environment* (Toronto, 1986); P. Soldatos, *Continentalism Revisited: The CUFTA Option*, Harvard University, University Consortium for Research on North America, 1985 (to be published as a chapter in L. Feldman and P. Soldatos, eds., *New North American Horizons*).

2. See infra, Table I (columns II and III).

3. See *ibid.*

4. See p. 20 of the Third Option document, M. Sharp, Les relations canado-américaines, in *Perspectives internationales*, (Aut. 1972).

5. See the six national aims, in the 1970 "White Paper" (*infra*, Table I, column III).

6. 1972 Document, *loc. cit.*, p. 18 (translation from the French text).

7. On this springboard concept, see, notably; Ch. Pentland, L'option européenne du Canada dans les années 80, in *Études internationales*, 1983, no. 1, p. 41; see also the speech given in Winnipeg by Allan MacEachen, in January 1975.

8. On "World Product Mandates", see notably: Perron, Br. and Bonin, B., *Les mandats mondiaux de production*, Les Cahiers du CETAI/HEC, no. 83-04, (1983) P.-P. Proulx, North American Trade in a Changing International Context: The Role of World Product Mandates, paper delivered at a conference in Toronto, October 1981.

9. For the proponents of a Canada-U.S. free trade or other forms of integration, both from the Canadian and American points of view, see the references in our study, Les données fondamentales du devenir de la politique étrangère canadienne, in *Études internationales*, (Mars 1983), especially notes 21, 22 and 23.

10. See, especially, the Canadian Government's publication: *A Review of Canadian Trade Policy*, 1983, and *A New Direction for Canada*, 1984.

11. On the debate between proponents and detractors of Canada-U.S. free trade, see notably: Canada-United States Trade and Policy issues, in *Canadian Public Policy*, special issue, (October, 1982) VIII, Supplement (especially the contributions of P. Wonnacott and R.J. Wonnacott and B.W. Wilkinson); several written briefs to the Royal Commission on Economic Union and Canadian Development Prospects; presentations at a Commission seminar, in October 1983, on Canada-U.S. free trade (see esp. the papers delivered by C. Beigie, H. Eastman, R. Harris, F. Lazar, M. Watking, B. Wilkinson, R. Wonnacott).

12. *Canada-United States Relations*, vol. III, 1982, pp. 102-109.

13. See notably Peyton V. Lyon, *Canada-United States Free Trade and Canadian Independence*, (Ottawa, Information Canada, for the Economic Council of Canada, 1975). See also his study, "Second Thoughts on the Second Option", in *International Journal*, (1975).

14. On this anticipated reaction, see N. Black, "Absorptive Systems are Impossible: The Canadian-American Relationship as a Disparate Dyad", in A. Axline et al., eds., *Continentalist Community?* (1974), pp. 92-108.

15. Quoted by R.D. Hansen, "Regional Integration", *World Politics* (1969), p. 244.

16. Quoted by R.D. Hansen, *Ibid.*

III

Economics and Free Trade: The Pros and Cons

Canada's Trade Options

Richard G. Lipsey

Preliminary Observations

First, in the usual debate, or symposium, one usually gets anywhere from 10 to 30 minutes to cover all of the topics in the free trade debate. Having spent a year writing my book with Murray Smith on the subject,[1] I realize that the issues, some of them very subtle, cannot be compressed into a 20 minute talk. Concerned people who come out to listen certainly do learn something, but inevitably they are presented with a superficial view. It does not matter how many such meetings they attend, the constraints on each still condemn them to hear superficial treatments over and over again.

But something is better than nothing, so we should be glad that so many people are coming out to listen to the various points of view of the Great Canadian Free Trade Debate. I doubt that many economic issues in our whole history have aroused this much public interest. For that reason alone, we are participating in something that is truly historic.

Second, the debate is highly charged emotionally and arouses apocalyptic predictions. This is a shame. The free trade area that is being proposed is pretty prosaic. Consider the main precedent. When the six original members of the European Community – France, Germany, Italy and the three Benelux countries – formed their tightly knit common market, a number of neighbouring countries got worried. They saw themselves excluded from the Community's vast market, but they wished to avoid the common market's strong harmonization pressures. So they formed the European Free Trade Area, EFTA, which was designed to give them access to the market of the EEC, while avoiding pressures that membership in the community would entail. Sweden is a member of EFTA, and Sweden has been able to maintain its very distinctive social policies while enjoying access to the EEC market.

This is the model for the projected Canadian-American free trade association (CAFTA). The purpose is to allow Canadian firms access to the vast market in the U.S., while avoiding both the need to harmonize Canadian policies with respect to other countries – as is required by both a customs union and a common market – and the need to allow free movement of capital and labour – as is required by a common market.

It is hoped that a CAFTA will give Canadian firms enhanced access to the mass Canadian-American market as well as protecting the limited access they now have. The issues that are raised by this initiative are interesting and Murray Smith and I have discussed them elsewhere.[2] Clearly, reasonable people can come to different conclusions about how to respond to these issues. These responses are what we should be discussing today in Canada.

Unfortunately, however, much of the debate has been on illusory issues. At the "alternative summit" in Ottawa in April 1987, a nurse told how she opposed the CAFTA because she did not wish Canada to import the "rotten" American health care system. A teacher at a recently televised conference in Toronto told his audience that he opposed the CAFTA because he wished to teach his students about Tommy Douglas rather than Abraham Lincoln!

It is sad that this level of irrelevancy has been introduced into the debate. A free trade area has nothing whatsoever to do with policies with respect to health, education and a host of other broad issues. Even within the much tighter European Common Market these broad policies have not been harmonized. Where the teachers, nurses and several other groups now lined up against free trade got their ideas that a CAFTA would affect such things as our health system and our educational curricula is an interesting question.

Third is the rich strain of anti-American sentiment in Canada that is being exploited by opponents of a CAFTA. I have heard audiences roar approval at the argument that, because Americans send an icebreaker through the North West Passage, thus challenging our sovereignty, we should not sign a free trade agreement with them.[3] Sad is the day when we cannot separate issues of political jurisdiction from issues of our future as a trading nation.

I will yield to very few people as a reasoned critic of U.S. foreign policy. I think American policy was, and is, misguided on Vietnam, Cambodia, South West Africa, Star Wars, Cuba and Nicaragua, to mention a few instances. Some of their foreign policies are, I believe, a serious danger to our survival on this planet. But we do live next door to them, and we do have to trade with them. My barber is a fascist, and I suspect my grocer is a monetarist, but that doesn't stop me from dealing with them for our mutual advantage. Similarly, just because I think American foreign policy is misguided, this is no reason to harm Canadian welfare by not trading with the U.S.

My fourth general point concerns the insecurity of the Canadian identity, on which the opponents are playing by telling us that a CAFTA will be the end of the Canadian identity. I have written about this elsewhere and so will not repeat these comments here. Suffice it to say that I believe there is a strong Canadian identity that is rooted in our historical experience, in our distinctive geography and in the patterns of our waves of immigration. I believe this identity will survive a little more "truck and barter with the Yanks," which after all means doing just a little more of what we have been doing for a long time without losing our identity.

With these four general points out of the way, let me pass to a brief consideration of Canada's trading options.

The Status Quo

The search for new trading options began when many economists concluded that the present trading status quo was not sustainable. The status quo means maintaining our present policies, but these policies have been leading the country into a rapidly deteriorating trading situation. The reasons that led me to that conclusion are laid out in Lipsey and Smith (see footnote 1) and I do not have the space to duplicate them here, so I will just mention a few key points.

First, Canadian access to foreign markets is a much more serious issue today than it was in the past. Before the Second World War, Canada's prosperity was heavily dependent on resource industries, with a high-cost, protected manufacturing sector mainly serving the home market. Canada was a major contributor to the world's supply of many primary products. Thus, Canada did not need to worry about access to the world's markets; the world beat a path to Canada's door. By the 1980s, however, the prosperity of resource-based industries has been seriously hurt by international developments in the form of new sources of supply and new, man-made substitutes for many natural materials. Fortunately Canada, along with the rest of the industrialized world, embarked in 1947 on a policy of tariff reduction under the newly formed GATT. As a result of tariff reductions negotiated under the GATT – along with the auto pact, which is a bilateral arrangement for free trade in autos and auto parts between Canada and the U.S. – many Canadian manufacturing industries have developed to the extent that they can export successfully. Given its hard pressed resource-based industries, Canada's future must depend more and more on its ability to export manufactured, and service-related products. But the world does not beat a path to Canada's door for its manufactured goods, or its traded services. The world's manufacturing markets are fiercely competitive, and Canada must worry greatly about market access; not only to gain better access, but to preserve what it already has.

Second, the GATT is in serious trouble and unable even to maintain the present level of trade liberalization, let alone offer prospects of the increase in market enhancement that was needed for Canadian exporters. As an example of these worries, the GATT Secretariat recently wrote of the "increased difficulty, not only in furthering trade liberalization, but also in safeguarding previously negotiated levels of market access." Gerard and Victoria Curzon, world-trade-law experts, were even more outspoken in saying:

> [The GATT] is now incapable of halting daily violations of its most innocuous rules, let alone defend its basic principles. Evidence of breakdown is everywhere . . . [A]n undeclared trade war is in progress.

Such observers have little hope that Canada could protect itself from the current aggressive use of American countervail laws by using the GATT appeal mechanism.

Third, many GATT observers anticipate very few gains on further trade liberalization from the next round of negotiations. Canada must push as hard as possible for multilateral tariff reductions within the GATT, but to tie Canada's prosperity as a trading nation exclusively to the success of the next round of GATT negotiations is a very risky course.

Fourth, the rise of world protectionism threatens the access that Canadian exporters already have to world markets. This is particularly worrying with respect to the U.S., which is our major trading partner and one of the leaders in the rise of world protectionism. In a misguided attempt to blame their trade deficit on unfair foreign trading practices, rather than on their domestic budget deficit, the U.S. has embarked on a unilateral attack on real and imagined foreign subsidies. Since Murray Smith and I first expressed this worry several years ago, a number of major Canadian exports have been subjected to U.S. countervailing duties and several more, including those of the auto industry, seem at risk in the near future.,

The threat of countervail is much more serious for Canadian-based firms serving the combined Canadian-American market than it is for American-based firms serving the same market. When both markets are served, the bulk of a Canadian-based firm's output is exported while the bulk of the output of U.S.-based firms is sold on the domestic market. The result is strong incentive for successful Canadian exporters to move plants to the U.S. to avoid existing and feared future American trade barriers. Currently the significant flow of Canadian direct investment that is going to the U.S., and taking jobs with it, attests to the strength of the attraction. (Incidentally, the volume of foreign investment in the U.S., much of it Canadian, is large enough to suggest the worry that in the 1990s Canadians may be trying to shield their investments against an American nationalist backlash that will mirror nationalist measures taken against foreign investment by Canada in the 1970s!)

Finally, in the status quo, Canadian sovereignty is being attacked. In the softwood lumber case, for example, long-standing Canadian resource policies were suddenly, and unilaterally, attacked by the U.S. Canadians have real cause for concern that almost any social policy may be perceived at some point in the future as providing an unfair subsidy to trade and thus become the reason for new American countervailing duties.

The Options

By 1985-86 a wide consensus had grown up that policies to break away from the status quo were urgently needed. There was much more agreement, however, on the need for change than on the direction that the change should take.

One group of Canadian nationalists called for an inward looking option.[4] They proposed a return to some modern form of National Economic Policy which would increase reliance on the home market. This would be done by using trade restrictions to encourage import substitution. An active industrial policy would then be used to provide the incentive for growth. I have criticized this policy elsewhere, and suffice it to say here that it has appealed to very few economists or policymakers. It does not solve two problems: that the Canadian economy is too small to provide an adequate market for many modern industries and that such a policy invites a trade war with the U.S. This is a war from which Canadians would emerge as losers since 20 per cent of our GNP is directly generated by trade with the U.S. while only 2 per cent of U.S. GNP is generated by trade with Canada.

For those who reject the inward looking option, some form of outward looking option seems the only other choice. Such options use export enhancement by continuing the policy of tariff reduction that was started in the late 1930s, and continued through successive rounds of GATT-negotiated tariff cuts.

Outward looking options come in three distinct versions. The first are sectoral deals taking the auto pact as model. These appealed to those who recognized the importance of trade to Canada, but preferred a more managed approach than just turning market forces loose. For a year quiet Canadian-American negotiations sought to liberalize trade sector by sector. The American administration was skeptical, but felt it had to give polite attention to the Canadian initiative. No one ever explained how such bargains, assuming they could be struck, would get by the GATT, whose regulations say that all tariff reductions negotiated bilaterally must be made available to other member nations on a most-favoured-nation-basis – unless they are part of a broad-based free trade area which covers substantially all the trade between the contracting parties. The auto pact avoided this GATT requirement because, in the 1960s, the North American auto market seemed effectively segmented from the market in the rest of the world. Today that argument would not hold up for autos, and it is not clear that it could be successfully made for any major commodity. In the event, the negotiations were halted.

No one can ever be quite sure why secret negotiations come to an end, but a major reason was that sectoral negotiations force both parties to look for sectors where both can gain. Such sectors are not easy to find, since more often than not one country will get the balance in other sectors. But, by their very nature, sectoral negotiations make it hard to take that overall view, and the search for sectors where the gain is obviously mutual tends to rule out most of those where major gains might be achieved.

The second major approach is to work exclusively through the GATT. But the severe difficulties already mentioned make this a particularly risky option.

Rejection of these two options leaves bilateral trade enhancement with the U.S. as the only remaining one. Supporters of the bilateral option see it as one prong of a two-pronged push for trade liberalization, the other prong being the multilateral approach through the GATT. Some supporters of the GATT-only option worried that Canada could not successfully pursue both options at the same time. But since the free trade negotiations largely preceded the GATT negotiations, this did not become a serious issue in practice.

Supporters of the bilateral option hold that the status quo is too risky to be accepted, that the CAFTA option gives Canada a chance to negotiate with the U.S. bilaterally to protect itself from current unilateral American attacks on existing access to the U.S. market, and that it is the only likely way of enhancing Canadian access to a mass market and making that access secure enough so that successful Canadian exporters will be willing to serve the entire market from locations in Canada.

Opponents should be called on to provide their reasoned answers to the questions implicit in the supporter's arguments. Do you believe, they should be asked, that Canada can stay with the status quo and, if so, how do we deal with the issues of maintaining the access to foreign markets we have, increasing that access, and preventing a steady exodus of Canadian firms to the U.S.? If you accept the majority position that the status quo is untenable, would you turn the country inwards or outwards? If inwards, how could Canada adopt a policy of import substitution without causing a massive and destructive American reaction, and how could an (inevitably small) protected Canadian market provide the base for Canadian industrial prosperity – be specific industry by industry? If Canada is to look outwards but not negotiate bilaterally, how do you sustain your optimism about the possibilities in the face of the opinion of most GATT watchers, and the GATT secretariat itself, that the GATT is in serious trouble in protecting the present level of world trade, let alone enhancing it?

Canada is faced with difficult choices, and reasonable people will surely disagree about them. I wish that the debate could stick to real issues about how to craft a limited trade enhancement agreement in our own best interests, rather than imaginary issues about loss of social welfare systems or national identity when we consider going on doing what we have been doing since 1935 – liberalizing our trading relations with the world in general, and the U.S. in particular whenever that is possible.

Notes

1. For a discussion of the issues addressed in this paper, and many other related ones, see R.G. Lipsey and M.G. Smith, *Taking the Initiative: Canada's Trade Options in a Turbulent World*, Observation no. 27 (Toronto, 1985). For a semi-historical account of the evolution of the policies that led to the current negotiations, as well as an analysis of some of the main issues in the negotiations, see R.G. Lipsey, "Will There be a Canadian-American Free Trade Association?" *The World Economy* 9 (September 1986): 217-238. For a brief discussion of what the Reagan administration hopes to gain, see Lipsey and Smith, *Taking the Initiative: Canada's Trade Options in a Turbulent World*, pp. 82-83. For a discussion of the U.S. political economy of its approach to Canada in the wider context of the current U.S. budget and external trade deficits, see R.G.Lipsey, "American Commercial Policy and the Crisis in the World Trading System: with special reference to Canadian-American Trade", The Persident's Distinguished Lecture read at the general meeting of the North American Economists and Finance Association, New Orleans, December 29, 1986 (Toronto, C.D. Howe Institute, Mimeographed).

2. On the question of harmonization pressures, see *Policy Harmonization: The Effects of a Canadian American Free Trade Area* (Toronto, 1986).

3. See for example A. Rotstein, *Rebuilding from Within: Remedies for Canada's Ailing Economy* (Ottawa, 1984), and C.G. Pilkey, "Free Trade or Fair Trade: A Question of Who Profits", in D.W. Conklin and T.J. Courchene, eds., *Canadian Trade at a Crossroads: Options for New International Agreements* (Toronto, 1985), pp. 33-34.

4. *Ibid.*

The Free-Trade Initiative: On Course or Off?

Irving Brecher

I would like to begin with a one-part question-answer quiz. Question: what do the current negotiations on Canada-U.S. free trade have in common with the Golden Nugget Casino in Las Vegas? Answer: an incredible cast of characters playing for high stakes and an uncertain outcome, in an atmosphere full of hot air and meandering clouds of cigar-smoke.

Hot Air and High Stakes

The cigar-smoke is, of course, peripheral, but the hot air is not. Seldom, if ever, has more nonsense been uttered by more people about a major Canadian initiative in economic policy.

There are, in fact, some legitimate grounds for Canadian concern, and it is important that they be bluntly expressed. For all our growth, we remain the proverbial mouse living beside the U.S. elephant. And size is not the only difference, despite a formidable array of similarities. For some of us, it is our blend of U.S. and British institutions that is most distinctive. For others, it is a stronger conception of regional balance, or a more activist governmental role in social development. For still others, it is a matter of ethnic or linguistic justice. For some, indeed, it is the option of forgoing the rhetoric of distinctiveness. Whatever the ambiguities, there is something "Canadian" about this society which most of us wish to sustain and promote in the face of serious risk posed by U.S. size and proximity.

Our cultural and political concerns are real and profound. But this is a far cry from the argument that Canada should walk away from the free-trade talks. These concerns are endemic. They have always been a fact of Canadian life; and they will continue to haunt us whether we conclude an agreement or not. The pertinent question is whether a closer, more formalized trading relationship with the United States would be incompatible with Canada's viability as a nation. I, for one, can find no logical way of coming up with an affirmative reply.

The Macdonald Commission put it well back in 1985. Suffice it, for now, to say that the security afforded by a well-crafted agreement would do much to soften Canadian unease over a vulnerable nationhood; and that given the political will, national unity and strength could only benefit from the large, widespread increases in Canadian incomes which would flow from freer Canada-U.S. trade. Hot air actually *falls* when those claiming exclusive title to "Canadian nationalism" declare that the federal trade initiative will do grave and irreparable damage to Canada's sovereignty.

The hot air gets steamy as the public debate grinds on. And then comes the fog. The issue of economic gain is another case in point. There are those who contend that Canadians do not yet know enough about the likely economic consequences of a bilateral free-trade agreement to make a rational decision on whether to seek it. This is patent nonsense. Uncertainty (to which I shall soon return) is one thing, ignorance quite another. From Walter Gordon to Donald Macdonald, from John Young and the Wonnacotts to Richard Harris and the Economic Council of Canada – no policy issue has come under more intense research scrutiny during the past 30 years.

No less invalid, if more subtle, is the argument that successive multilateral rounds of trade liberalization have already brought us the bulk of the available economic benefits, and that a Canada-U.S. deal is just not worth the trouble. True, we have reaped substantial gains. But there are lots more to come. The most careful research on freer trade with the United States continue to show that Canada can expect significant increases not only in economic growth but in employment as well. According to recent simulations of the Economic Council, for example, a phased mutual elimination of tariff and non-tariff barriers would produce a broad 3.3 per cent rise in real output and over 320,000 new jobs by 1995.[1] These are high stakes. And they go much higher when we reflect on the half-a-million Canadian jobs that could be lost through increased U.S. protectionism in the years ahead.

With good luck and skilled bargaining, the GATT's newly launched Uruguay Round may well reverse recent trends towards a more managed, more protectionist world trading system. But the argument that the Canada-U.S. route should therefore be abandoned–or, euphemistically, "merged" with the GATT talks–is as close to a *non-sequitur* as one can get.

It is worth repeating that we shall find no magic wand to rid us of our cultural and political concerns *vis-à-vis* the United States. And anyone who implies that the new GATT round will not be difficult, protracted and in varying degrees frustrating, is either practising the art of obfuscation or living on some other planet. Agriculture and services will continue to be bitterly contentious. More to the point, the Canada-U.S. route stands a far greater chance of reasonable success in curbing our neighbour's growing appetite for restrictive interpretation of its so-called "fair trade laws" on subsidies and countervailing duties. A two-track policy makes sense for Canada. The bilateral and multilateral trade cars can and should each go forward without derailing the other.

Uncertain Outcomes

But whatever the track and however high the stakes, "uncertainty" is the name of the game. I want to stress two dimensions of Canada-U.S. uncertainty: the business and job dislocations arising from freer trade, and the prospects for concluding a free-trade agreement. These, of course, are not unrelated; in particular, ongoing perceptions of impact will affect the negotiating outcome.

The Adjustment Problem

For over a century, Canadians have been asking about the consequences of free trade with the United States. In essence, it is a "what if", hypothetical question. Thus there can be no sure and pure answers. I have already argued that the long-term economic benefits come close; and the cultural and political concerns are, to a large extent, misplaced or unwarranted. But if the real scope for uncertainty is narrow on these fronts, it is wide open with respect to the short-term disruptions occasioned by a more competitive trading environment.

The problem is not one of failure to acknowledge such transitional costs, but rather a virtual research void in terms of pinpointing the industries and worker-groups that are likely to bear those costs. This, obviously, is a difficult task. There has long been an awareness of the gap, however. And it involves costs that hit home because, though relatively modest, they could inflict severe hardships on individual firms and employees providing the lifeblood of local communities across the country.

Will There Be A Draft Agreement?

One type of uncertainty often begets another – in this case, an element of doubt as to the chances for a Canada-U.S. agreement on freer trade. But there is more. Are the negotiations really off course? Not being privy to them, I shall attempt an heroic reply.

Let me set the stage by commenting on various conceivable agreements. The possible permutations and combinations are almost limitless. One can, however, make some broad distinctions that are meaningful.

In the first place, I do *not* envisage an immediate mutual elimination of all tariff and non-tariff barriers; even if this were feasible, it would be unacceptable in both countries. Secondly, I am *not* thinking of an agreement that involves little or nothing more than a joint mechanism for the adjudication of trade disputes; at the very least, in my view, this would be unacceptable to Canada's negotiators. Thirdly, I do *not* contemplate either a common market or an arrangement confined to a few sectors or industries; the former would go too far for most Canadians, while the latter would be inconsistent with our federal initiative and with the spirit (if not the rules) of GATT.

What I *do* envisage is something historic, mutually beneficial on a large scale, and sensitive to the deepest concerns and aspirations on both sides of the border. Again, the conceivable specifics are enormously varied. There is no magic formula, even for the most skilled negotiators.

Here, nonetheless, are the outlines of one outsider's conception: a comprehensive agreement providing for a free-trade area between the two contracting parties, and affirming their strong adherence to the GATT system; under that accord, a commitment in principle to a phased mutual elimination of tariff and non-tariff barriers against all goods and services; the phase-in period to last, say, 12 years, with an immediate start for the United States and a two-year delay for Canada to reflect the differential capacity for adapting to increased foreign competition; a broad consensus on the need for exchange-rate flexibility, on less restrictive foreign-investment rules, on improved intellectual property laws, and on adjustment programs for mitigating agreement-related costs of job and business dislocation; a Canada-U.S. Trade Commission initially mandated to identify and access export subsidies and other unfair trade practices, and, after a reasonable period of experience, empowered to rule on the merits of countervailing duties; conditional exemption for particular industries—possibly in the farm, automotive financial and cultural sectors, for example—pending Commission study of the special problems posed by freer trade in those industries; also, within or through the Commission, machinery for general interpretation of the accord, for periodic ministerial and other official discussions, and for continuing research on bilateral trade and related issues and on Canada-U.S. trade vis-à-vis the rest of the world.

Needless to say, I have left plenty of loose ends. And there are elements of arbitrary detail. No matter. The point is that when I speak of the prospects for a free-trade agreement between Canada and the United States, I am not talking about any old agreement, but about one which cannot easily be broken, is comprehensive, yields significant mutual economic gains, confronts the problem of dislocation costs, provides for dispute settlement, and allows for member-country differences in size and in perception of the national interest.

Putting it this way might be taken as dictating an affirmative answer to the question of whether we can expect a successful negotiating outcome. It is not that simple, however. Even assuming a commonality of vision for me and the negotiators, it is a long step from negotiation to agreement. I have already noted a number of Canadian concerns and hang-ups. It is worth re-emphasizing that the anxieties over job losses and business failures ring loud and true. Much will depend on Ottawa's ability to articulate a more effective response in the coming months. But this is by no means all.

Who can ignore the frosty bilateral climate created by cascading U.S. trade restraints over the past year: cedar shakes and shingles, softwood lumber, steel, fish, hogs, and more? Not surprisingly, there has been no shortage of bitter Canadian reaction—much of it justified, some of it misguided, and some just plain foolish. For "misguided", read the retaliatory tariff on U.S. books, computer parts, diesel locomotives, tea bags and Christmas trees. For "just plain foolish", read the argument that the free-trade talks have brought on the irritants by giving Canada a higher profile *vis-à-vis* the United States. Be that as it may, there can be little doubt that the Canadian fall-out from recent U.S. forays into protectionism could blow the talks off course. I am betting that it won't; that Canadians will increasingly see such behaviour as all the more reason for pushing towards a bilateral system of free-trade rules.

Both chief negotiators are bound to be particularly sensitive to this problem. What else can an interested outsider reliably say about these two pivotal players? Perhaps not a great deal, but let me try anyway.

It would be difficult to conjure up an image of sharper contrast: Canada's incisive, articulate, battle-toughened veteran, Simon

Reisman; and United States' laconic young relative novice, Peter Murphy. I leave the more colourful character descriptions to others.[2] This, the Murphy "bombshells" on the Auto Pact and the cultural industries, along with the harsh Reisman replies – these are the stuff of headlines and gloomy forecasts. So are the shrinking time-frames for negotiation; and ludicrous American statements like Canadian culture being no more at risk to U.S. influence than *vice versa*.[3] But again, I am betting that the U.S. negotiating team has learned much from its Canadian counterpart about this country's special problems and sensitivities; that despite the inevitable differences in perception on details, both chief negotiators envisage the overall agreement framework which I have outlined here today; and that they will emerge with a significant compromise package by the autumn of this year.

Is There "Life after Draft"?

Still, even it I win these bets, there is ample room for derailment on the "fast track". Consider, first, the complexities of ratification in the United States. The biggest question-mark is, of course, the U.S. Congress. There, the protectionist tides run high in the happiest of economic times. Allowing for some impressive growth and inflation gains, these are not the happiest times – what with unemployment stuck at 6.6 per cent, a projected federal budgetary deficit of $135 billion, and a 1986 trade deficit at the record level of $170 billion. Add to this the post-November fact of Democratic party control in the Senate, accompanied by loud noises about early enactment of a trade bill that makes "competitiveness" a euphemism for stronger protection.

Even for a "free trade" President as committed as Ronald Reagan, it will not be easy to contend with such forces. He will also be entering his last year in office when the Canada-U.S. package comes up for Congressional approval. And he will probably continue to be distracted by "skeletons in the Iran-contra closet".

One could make a case for pessimism on this basis. I choose not to do so, for the following reasons. There is, firstly, a substantial amount of U.S. business support for a bilateral free-trade agreement.[4] In our preoccupation with the vocal critics, this is something that we tend to overlook. It is impossible to weight the support against the opposition. There is also considerable indifference. But it does seem clear that many U.S. business associations favour an agreement; and that they span a wide range of industries, including aluminum, chemicals, pulp and paper, printing, electrical manufacturing, and beer and wine.

Secondly, whatever else Congress may seek, it will not be extreme negative signals for the GATT Uruguay Round that U.S. hard work has helped so much to launch. Journalist Peter Cook cannot be far off the mark when he reports deep Congressional concern that if Washington fails to get an agreement with its northern neighbour -- many of whose trade policies are generally similar -- the United States will be seen abroad for the "self-interested, closed-minded country on free trade that, in truth, it has largely become."[5] The bilateral talks provide a litmus test for U.S. *bona fides* in the upcoming negotiations on freer multilateral trade.

Symbols are important in other ways. Reflect, for a moment, on Democratic-party control in the U.S. Senate. It was not easily achieved, nor will it be easily retained in 1988. And the Democrats are already caught up in the hunt for an elusive Presidency. I believe that, notwithstanding the protectionist noises, they will lean over backwards to project an image of reasonableness on the world-trade front; and that reservations about a Canada-U.S. agreement will be tempered by this objective.

In the crunch, though, it will no be image-making or friendship that will determine Congressional response, but rather U.S. perceptions of the prospects for economic gain. Understandably, Canadian discussion has been quite thin on this question. Trying to answer it is something like non-Quebec Canadians grappling with the question, "what does Quebec want?", during our Confederation crisis in the 1970s.

I believe that, in essence, Americans and Canadians are looking for the same kinds of gain in terms of output and market access; that the Americans are especially interested in broad-based elimination of Canada's trade and related barriers; that while smaller relative to the total economy, the U.S. benefits would be significant nonetheless; and that most key U.S. players will ultimately perceive this to be so.[6] I also believe that the draft agreement will be consistent with U.S. basic aims: that the President will not attempt major changes before or after submitting it to Congress; and that empowered only to accept or reject, Congress will be inclined to resolve any doubts in favour of acceptance.

I am, indeed, more worried about the agreement's fate on the Canadian side of the border. Economic gains loom very large, to be sure. And there is strong, unprecedented support among business leaders across Canada. (The fact of extensive current subsidization of business in both countries may help to generate a bilateral consensus on subsidies that should not be subject to countervail.) But if there is the potential for greater Canadian long-term gain, there is the risk of heavier short-term loss. Ottawa has yet to articulate a solid program for easing Canadian concerns about adjusting to the job and business dislocations that an agreement will bring. In the light of its stated plans and of ongoing Economic Council research, I am prepared to express some cautious optimism on this issue.

There are other problems, however. Ottawa can count on unrelenting pressure from all those "strange bedfellows" who are united in the conviction that a free-trade agreement with the United States would be an economic, cultural or political disaster – or some combination thereof. And their voices will grow more shrill as the time for the final decision draws closer.

There is also the "provincial ratification" problem. The provinces present a mixed bag of attitudes towards freer bilateral trade – some enthusiastic support among Western and Atlantic governments, a blend of coyness and sympathetic concern in Quebec, abundant hostility in Ontario. Bear in mind the importance of provincial trade barriers and the responsibility of the provincial governments for getting them eliminated. Ontario seems to spend much of its time producing studies that equate vulnerability to open markets with lost jobs and reduced incomes. The Premier of Quebec muses about Canada's political viability under free trade. And both provinces call increasingly for a constitutional formula that would require provincial ratification of any free-trade accord signed by the Canadian government.

The provincial constraint could prove to be particularly serious. (Professor Albert Breton has been moved to comment that "If the trade question becomes constitutionalized, the six years of negotiation required to conclude the Tokyo Round of GATT will be remembered as if they had been a breeze)".[7] In a sense, the final outcome boils down to a question of Ottawa's political will.

A number of Canadian scenarios are conceivable at the draft-agreement stage. The federal government might opt for rejection. Strong negative signals from the Reagan Administration could provide Ottawa with an easy way out. This excuse, as I have already argued, is not likely to be available. And outright Canadian rejection of a compromise draft would otherwise be widely viewed, in this country, as an act of political cowardice that virtually sealed the Prime Minister's fate.

A more realistic possibility is that Ottawa will seek to dilute the draft agreement in far-reaching ways, even to the point of abandonment if necessary. This "death by amendment" approach might be tempting to a government plagued by credibility problems and looking nervously ahead to national elections in 1988 or 1989. However, it is unlikely that the White House would join in any such exercise. And it is a near-certainty, in my judgment, that Canada's chief negotiators would not remain publicly silent in the face of such an assault on the Reisman-Murphy draft.

I believe that Ottawa will go the "acceptance" route, perhaps with relatively minor amendments to the proposed agreement; that despite the mounting pressures, it will retain the draft as the centrepiece of its economic programs; and that given this reality as well as growing doubts about the alternatives, provincial-government posturing will give way to a workable process of ratification and a positive outcome.

Last Bet

It is time to return full-circle to my Las Vegas analogy. I would not wish to leave the wrong impression. While I am *sure* about my own support for Canada's free-trade initiative, I am *betting* that it is basically on course and that it will stay on course. I close with a variation on the theme from the classic film, "Casablanca": a bet is just a bet, after all.

Notes

1. *Changing Times*, Twenty-third Annual Review (Ottawa, 1986), p. 25.

2. See, for example, Jennifer Lewington, "Enraging Canadians Just a Job for Envoy", *The Globe and Mail*, January 31, 1987.

3. "Fighting Words on Trade", *Maclean's*, (February 16, 1987), p. 16.

4. J.A. Litvak, "Freer Trade with Canada: The Conflicting Views of U.S. Business", *Business Quarterly*, (November, 1986), pp. 44-51.

5. "Ugly American Mood May Hurt – and Help Talks", in *The Globe and Mail*, February 4, 1987.

6. See P. Wonnacott, *The United States and Canada: The Quest for Free Trade*, (Washington, D.C., 1987).

7. *The Globe and Mail*, January 6, 1987.

"Truck and Trade with the Yankees": The Case for a Canada-United States Comprehensive Trade Agreement

Thomas d'Aquino

For a second time in a century, in all parts of this country, Canadians are engaged in an emotional debate about our future economic relationship with the United States. The debate is about free trade – it is about jobs, markets and future growth. Not surprisingly, the debate is also about culture, political independence and sovereignty.

In my address today, I will deal with both the economics and the politics of this issue and explain why leaders who make up the Business Council on National Issues support so strongly the idea of a comprehensive trade agreement between Canada and the United States.

The Free Trade Debate – The Lessons of History

Let me begin by reviewing with you some of the colourful history surrounding this question. The last time we Canadians grappled with this issue in such a spirited way was in 1911. At that time, it involved a young Canadian nation, made up largely of individuals whose ancestors had rejected the American Revolution, and who had established, against great odds, Canadian sovereignty from the Atlantic to the Pacific. The debate pitted Liberal Prime Minister Sir Wilfrid Laurier – a passionate advocate of free trade – against a protectionist Conservative Party in opposition, and significantly, a majority of industrial interests centred in the provinces of Ontario and

Quebec. At the heart of the debate was a generous proposal from the Taft Administration calling for "reciprocal trade in natural goods and some manufactured ones. . . ." Under the agreement, United States tariffs were to fall in most categories while most Canadian tariffs were to remain intact. The resulting Reciprocity Agreement of 1911 won quick support in the United States. The House of Representatives approved it by 268 to 89; the Senate by 53 to 7. In Canada, on the other hand, the opposition to the Agreement grew. In the end, following a general election, both the Government of Laurier and the Reciprocity Agreement were defeated by a coalition of nationalists and protectionists. "No truck or trade with the Yankees," they cried, and the alarmed voters listened. The Liberals were swept from power, and the issue of free trade passed into obscurity. Never again in the 20th century did the issue dominate the national agenda until now.

You will recognize in the current debate some disturbing similarities to the debate in 1911. Once again a coalition of nationalists and protectionists are asking you and me to believe that a free trade agreement between Canada and the United States will not be in Canada's best interests economically. They are also asking you and me to believe that such an agreement will lead inevitably to the extinction of our independence as a nation. A majority of Canadians – the country's business leaders among them – cannot accept these propositions. Here is why.

The Virtues of Trade Liberalization

I will begin with the economic case for freer trade generally, and some simple facts. Canadians export more per citizen than their counterparts in any other industrial power including Germany, the United Kingdom, Japan and the United States. Over 30 per cent of our national income is generated by exports. More than three million jobs – greater than one-quarter of our workforce – depend on export trade. Of this trade, the United States absorbs almost 80 per cent. This southward flow of our commerce provides jobs to over two million Canadians.

We can agree quickly on the facts of Canada's export trade. But do we always appreciate the critical link between trade on the one hand and growth and jobs on the other? Did you know that since the Second World War, the value of our exports has increased more than twelvefold? And did you know that during this period we achieved extraordinary economic growth at the same time that barriers to trade were being lowered throughout the industrialized world? Exports have built our nation. Exports have provided us with one of the highest standards of living in the world.

By no means is Canada the only beneficiary of four decades of trade liberalization. Other industrialized countries have seen huge increases in real income as well. And just as significantly, hundreds of millions of people in less-developed countries have benefitted from their products gaining freer access to the markets of industrialized countries. In the post-war world, trade liberalization became a powerful engine of growth, jobs, and opportunity. This period has been referred to as the "most dynamic single generation of widespread growth in human history" – a time when the world's annual output of goods and services tripled.

What was the world like before this global move toward trade liberalization? It was a time when the protectionists held sway, when beggar-thy-neighbour policies were commonplace. It was a time of world depression, of massive unemployment, of hunger and misery. In Canada, the election of 1930 brought to power the Bennett Government on the platform of "Canada First". In the United States, the Congress passed the Hawley-Smoot legislation which raised tariffs on United States imports to prohibitive levels. By 1933, Canadian exports to the United States had fallen to one-third of the 1929 level and imports had fallen to one-quarter. The hard lessons of the thirties should have taught us a great deal – most importantly that blind protectionism is a dead-end street. To give into it is to accept inevitable economic impoverishment and, in time, moral impoverishment as well.

The Economics of the Canada-United States Initiative

Today, trade liberalization remains a dominant imperative of the global agenda, and the Canadian government and the Canadian business community remain vigorous proponents of the dismantling of trade barriers at the multilateral level. But since the early 1980s, we in the Business Council on National Issues have also advocated the conclusion of a comprehensive free trade agreement between Canada and the United States.

What does a "free trade agreement" mean?

Before outlining our reasons, let me be perfectly clear about what we mean by a "free trade agreement". I am talking about a legal undertaking between two nations that accords with the provisions of the General Agreement on Tariffs and Trade (GATT). The GATT defines a free trade area as one in which the barriers would be removed from "substantially all the trade" between the parties to the agreement.

In opting for such an arrangement with the United States, the Business Council rejects both a bilateral customs union or a common market. A customs union, in our view, goes too far. It would provide for unrestricted movement of goods and services between Canada and the United States, and for common tariffs and other trade barriers against third countries. A common market goes even further. It would add to the features of a customs union the free movement of labour and capital between the two countries.

Here, I want to dispel a myth commonly associated with the free trade idea by our critics – the belief that a free trade agreement leads to a rapid dismantling of all barriers to trade. This is not the case. The full terms of a free trade agreement are usually implemented over time, with transitional arrangements for some industries and with adjustments for affected workers. Even in its advanced stage, a free trade association might still permit some degree of so-called "managed trade." Free trade is not a black or white issue as some would have us believe.

An agreement will reduce Canada's vulnerability

What then are the principal arguments that favour a commitment to a comprehensive free trade agreement. Let me begin with the advantages of a formal agreement itself. The Canada-United States trading relationship is the world's largest by far. This year, trade in goods between the two countries will exceed $165 billion. If services such as travel, shipping, insurance, telecommunications and engineering are included, the amounts probably will exceed $190 billion. Millions of transactions take place daily across a border which unites an already highly integrated market. This two-way relationship is much too big and much too important to be left to chance. The time has come to encompass it within the rules and discipline of a bilateral agreement. Without such rules and discipline, the law of the jungle will apply, and in the jungle the strong usually have their way.

What might such an agreement look like? It would provide for the dismantling of existing tariffs on goods shipped between the two countries. Provision would be made for some tariffs to be phased out in order to allow more time for workers and industries to adjust. The agreement would deal with measures such as subsidies and countervailing duties, dumping and anti-dumping duties, and emergency safeguard actions. Recourse to these remedies would be subject to mutually agreed rules. Discriminatory government procurement practices would be addressed. So would the complex area of trade in services. And an effective dispute resolution mechanism for dealing with trade conflicts would be included.

Recent experience has taught us that in the absence of a formal agreement, we in Canada are seriously vulnerable to American protectionist actions aimed directly at us. What better examples can I offer than the cases of shakes and shingles and softwood lumber? In recent years, quotas, surcharges, anti-dumping, and countervailing duties have in one way or another affected over $6 billion of Canadian exports to the United States. The industries threatened provide close to 150,000 jobs. But we are also being hurt by American protectionist actions aimed at others. Consider the serious damage to Canadian wheat farmers that has resulted from disputes between the United States and the European Community.

Yes, we are enormously vulnerable to United States protectionism, and an agreement would reduce that vulnerability. But support for the federal government's trade initiative among Canada's business leaders is not based simply on fear that access to the American market will be curtailed. The support has a positive dimension, and this perspective has not received the attention in the current debate that it deserves.

Beyond fear – the positive case for freer trade

First, because of the difference in the size of the two economies, freer trade holds out the promise of providing greater benefits to Canada than to the United States. The United States economy is about 10 times bigger than ours. Freer access to it opens up vast opportunities. By way of example, did you know that a mere one per cent increase in Canada's share of the government procurement market in the United States – a market worth some $750 billion and which is largely closed to us – would result in some 75,000 new jobs in this country? And this is the tip of the iceberg. The predominant view among economists who have studied the costs and benefits of bilateral free trade is that Canada's gross national product would rise by three to eight per cent. This consensus is supported by the findings of the Macdonald Royal Commission.

Second, improved access to the huge United States market of some 250 million people will help us come to grips with the problems that threaten our competitiveness. It would encourage larger, lower-cost production in our factories. It will help us address one of the worst productivity records in the industrialized world by making our industries more specialized and more efficient. It would strengthen our capacity to compete in our own market, in the United States market, and particularly in the highly competitive global marketplace.

We would see the benefits of this improved competitiveness in very concrete ways. The prices of many of the things that we buy would fall. The incomes of Canadian households would rise. So would consumer spending and investment. In the wake of all of this, jobs would grow. As a nation, we would have a better chance of remaining among the world's leading economic powers.

The third reason why Canadian business leaders favour freer trade with the Americans is that it would make Canada a more attractive place to invest – more attractive to Canadians themselves, and to foreign investors as well. I have spoken to many in the United States, Europe and Japan who see secure access to the United States market under the umbrella of a comprehensive trade agreement as an alluring prospect. As things stand now, a combination of tariffs, other barriers to trade, a fear of growing protectionism in the United States, and the lingering effects of nationalist policies in our country, have driven a great deal of investment away from Canada. This has cost us dearly in lost opportunities.

There is another reason why Canada's business leaders favour freer trade with the Americans. A bilateral trade pact would help address one of the most frustrating economic problems we face – a problem that the protectionists appear little concerned about. I am referring to the barriers to free trade that we Canadians have erected against one another in our own country – barriers that have impeded the free movement of goods, labour and capital among the 10 provinces – barriers that have fragmented our already small domestic market and made us less competitive internationally.

We must look beyond the United States

In concluding this discussion on the economics of freer trade, I want to make two points very clear. Some critics are saying that in advocating a trade pact with the United States, the federal government and the business community are turning their backs on efforts to achieve world trade liberalization. Nothing is further from the truth. Government and business leaders alike strongly support the new round of multilateral negotiations launched at Punta del Este, Uruguay, and for good reason. At stake is over $2.6 trillion in annual world exports of goods and $800-900 billion in services and the need to restore order to a world trading system dangerously close to disintegration.

In fact, a Canada-United States agreement could further the goals of multilateral trade liberalization in some very significant ways. The agreement could embrace accords in areas such as services, intellectual property, and investment – accords which to date have largely eluded multilateral negotiators. It could provide a model to the 92 nations who subscribe to the General Agreement on Tariffs and Trade (GATT) on how to strengthen dispute-resolution mechanisms and on how to improve existing codes on subsidies and government procurement.

My second point concerns third markets. Our interest in reaching an accord with the Americans should not be interpreted as a willingness on our part to forsake other markets. The European Community is the world's largest market and offers Canada some attractive prospects in the long term. So do the fast-growing markets of the Pacific basin. Furthermore, Canada's business leaders believe that a stronger Canada in North America will magnify Canada's ability to compete in the global marketplace. Recently a Japanese businessman expressed this fact to me in his own words. "If Canada can't make it in North America," he said, "it will never make it in the world at large."

The Politics of the Canada-United States Initiative

In my remarks so far, I have explained why Canada's business leaders believe that on balance freer trade with the United States coupled with trade liberalization worldwide would produce positive economic results for Canadians. But in the process would we lose our political independence? Would our culture and our "Canadian way of life" gradually disappear? Would Canadian unity diminish? In my view, these things will never happen. Here is why.

Canadian sovereignty is not at stake

First, the Canadian and American economies are already highly integrated. A great deal of the trade that passes between the two countries already is free. And yet would any well-informed Canadian argue that we are less independent now than in the days of high tariffs? Can a case be made that we have a weaker sense of national identity now than say 30 years ago? I do not believe so. Will a comprehensive trade pact that results in the incremental dismantling of remaining tariffs and other barriers to trade erode our deeply rooted commitment to Canada? I cannot see why.

Second, the protectionists argue that freer trade today will lead, before long to a common market, and eventually to a Canada-United States political union. This argument has no foundation. In this century there is not a single example where a high level of trade liberalization between two countries led to political integration. And furthermore, there is no significant support in either Canada or the United States for a common market or a political union.

If the protectionists are confused, let's not let them confuse us or the issue. The arrangement being proposed between Canada and the United States is not new. It has been tried many times, and successfully. It is close in character to trade accords negotiated in the 1970s among members of the European Free Trade Association (EFTA), and between a number of Western European countries and the European Community. More recently the Australians and New Zealanders have concluded a free trade agreement. These accords aim to liberalize trade and provide more stable market access. They do not embrace the objective of economic integration, and there is not the slightest evidence that these agreements have eroded the political independence or the sovereignty of the countries that have signed them.

Culture is a special case

A discussion of political independence and sovereignty in Canada these days inevitably leads to the sensitive issue of culture. Many Canadians are genuinely worried that our cultural industries—those engaged in periodical and book publishing, records, film, and video—could not survive in a free trade environment. The subject provokes strong emotions on both sides of the border—witness the conflict in the mid-1970s surrounding the non-deductibility of advertising placed in foreign media, or the recent dispute surrounding Gulf + Western's acquisition of the Prentice-Hall book publishing company.

I share this concern. I believe that some Canadian companies in the cultural sector would be put at a substantial disadvantage by a combination of free trade and the elimination of present investment regulations which limit the right of foreign companies to establish themselves in cultural industries. With other products, Canadian companies can carve out niches and compete against their American counterparts. Canadian cultural products are not exportable in the same way. Many of them will have meaning only to us, so we can never hope to overcome American economies of scale in this area.

Why do Canadians make the linkage between cultural industries on the one hand, and the sovereignty question on the other? Why has this issue become so explosive? If you understand this issue, then to a large extent you have fathomed the psyche of Canadians. Consciously and unconsciously, we value and depend on the indigenous vehicles which express who we are as a people—whether through the pages of newspapers or books, the sound of records, or the images of film. To the extent that trade liberalization threatens their existence in Canadian hands, this will be seen as a menace to our independence as a people.

It was our awareness and sensitivity to this issue that prompted the Business Council, in testimony before Canadian parliamentarians more than a year ago, to argue that "care must be taken to protect sensitive sectors that are essential to the maintenance of Canada's political and cultural values . . . and where necessary, foreign investment and competition in the cultural sector should be controlled to ensure that this important area of our national life is not sacrificed in the quest for a more competitive Canadian economy."

Canada's national unity would be strengthened

It is appropriate to conclude this discussion about the politics of freer trade with comment on the impact of freer trade on "Canadian national unity. The impact would be positive and Canadians who live outside of Ontario and Quebec have long understood why. The Macdonald Commission summed it up this way: "It is probable," the Commissioners pointed out, "that the most significant and long-term effect of free trade would be . . . the removal of one of the most persistent and corrosive sources of regional alienation in Canada's political history." The Commissioners were referring, of course, to the belief—still strong in the regions—that the manufacturing and industrial economies of Ontario and Quebec are being protected at the expense of the regions.

An Agreement in 1988? The Beckoning Opportunity

In the course of my remarks, I have offered a response to those who oppose trade liberalization generally, and to those who oppose freer trade with the United States. In the coming months, the debate will rage on. We in the Business Council on National Issues welcome this debate. We see it as helpful in fostering a better understanding of how vital international trade is to Canada's political and economic well-being. But to be truly constructive, the debate must be rational and the parties to the debate must be prepared to listen. Otherwise, national dialogue on this important question will degenerate into acrimonious conflict.

The negotiations deserve a chance

It is with this in mind that I come to what is the most important of what I have to say. The Mulroney government, backed by a huge majority in Parliament, and by a significant majority in the country, has taken a courageous and imaginative step in committing itself to negotiations with the United States. The object of these negotiations is to explore ways in which the two countries can trade with one another more securely. It is to find ways to avoid costly trade disputes before they arise and to solve them quickly when they do. It is to strengthen our industries, expand our job opportunities, and improve our standard of living. It is to reach out and ensure that Canada remains a significant economic power in a mercilessly competitive world.

Can any responsible Canadian stand in the way of at least exploring these possibilities? Is it in our character to say to a great friend and ally that we are not even interested in discussing how we can work together more effectively on this continent? I do not believe so. But this means that Canadians must voice their support for the negotiations and for an outcome that will genuinely serve our interests.

I am pleased to say that this morning I was among a group of concerned Canadians that announced publicly our willingness to work together to advance our trading interests both globally and with the United States. The Canadian Alliance for Trade and Job Opportunities was born today under the co-chairmanship of the Honourable Peter Lougheed and the Honourable Donald Macdonald. The Alliance represents a broad spectrum of economic interests including consumers and businesses of all sizes. Insofar as the negotiations with Americans are concerned, the Alliance will fight for an agreement that is in the national interest – and nothing less.

The negotiations with the Americans are proving to be tough, but it appears that progress is being made in areas such as the dismantling of tariffs, government procurement, intellectual property, services, and dispute resolution. It also appears that Canada's Chief Negotiator, Simon Reisman, could possibly initial a draft agreement in October of this year. Ambassador Reisman has insisted throughout the negotiations that an agreement must provide Canada with a large measure of relief from American trade remedy laws. The Canadian business community stands squarely behind Ambassador Reisman in this demand.

The Americans, to be sure, are making many demands of Canada. I am confident that those that impinge in a significant way on our economic independence or that weaken our political sovereignty will be rejected by our negotiators. No Canadian I know advocates an agreement with the Americans at any price. The Prime Minister has made his position clear on this. He has stated that if an agreement cannot be struck that is in Canada's best interests, there will be no agreement. The position of Canada's business leaders is no less clear. The Chairman of the Business Council, David Culver, sums it up this way. "Our goal must be to conclude an agreement that is in Canada's national interest. Anything less would be unacceptable."

What's in it for the Americans?

It would be a mistake, in my view, to assume that the Americans hold all the cards in this negotiation. What's in it for them? The certainty of more exports and investment; more secure access to the Canadian market and to Canadian imports; a more predictable business environment for American enterprises; a "model agreement" that would enhance the United States bargaining position on the multilateral front, especially in the area of subsidies, services, procurement and dispute resolution; and a stronger partner politically and economically in North America.

The coming months will be decisive

The next 12 months will be decisive for the current Canada-United States initiative. In Canada, the draft agreement will have to withstand the tough scrutiny of the provinces, and of the Canadian economic community. In the United States, the draft agreement likely will generate considerable debate in the Congress – a Congress, as we know, that is more sharply protectionist today than when the trade initiative was launched.

The debate in Canada about our future economic relations with the United States is far too important to jobs, growth, and our future prosperity to have it become the subject of a titanic partisan struggle. Clear minds, dispassionate enquiry, and intellectual honesty is what this great debate needs. And this is what the people of Canada must demand of all those who are seeking to shape its outcome.

Looking Outward Again

André Raynauld

It is with pleasure that I accepted the invitation to address this distinguished audience on a topic which is the most important issue for Canada. I am not at all sure that Canadians will ultimately find the courage to support free trade with the United States, or even freer trade but a public debate such as this one can only help to increase our understanding and reduce the fears of uncertainty and change.

For my part, I fully support the U.S.-Canada initiative to undertake negotiations towards free trade between our two countries.

The title that I chose for this presentation is a reflection of the pride that I take in having issued, in 1975, as Chairman of the Economic Council of Canada, the Report *Looking Outward*. This is not just an attractive title; it is an attitude of the mind, a predisposition which is absolutely necessary in the kind of world we live in at the end of this twentieth century, with hundreds of millions of people travelling abroad each year, with instant world wide information, with production units of world scale, with preferences and aspirations pretty much the same across continents. The world has become a neighbourhood. If a country is not up to standards, it loses control over its people, over domestic savings, capital and enterprise. At that point, there is not much left to preserve or protect.

The Benefits from Trade Liberalization

To be up to standards in the present context means an ability to compete in world markets and to win; an ability to generate growth and productivity to increase the standard of living, to provide challenging and rewarding careers in all walks of life. This is indeed the essential benefit to be expected from a free trade arrangement with the United States. Or to put the matter slightly differently, free trade with the United States is the only realistic policy available to achieve these goals.

The evidence is overwhelming in my view on the economic benefits to be gained by such an arrangement.

Intuitively, it should be easy to understand why this is so. After all, a tariff is a tax borne by consumers in the form of higher prices and by workers in the form of lower real wages, other things being constant. The Canadian tariff is obviously paid for by Canadians, although the tariff revenue may be thought of as partial compensation. What is more important in the Canadian context, however, is that Canadians also pay for the U.S. tariff on Canadian exports and this time without compensation. This is because Canada, given its small size, is generally a price taker on the world or the U.S. market. When the U.S. government imposes a 10 per cent duty on U.S. imports from Canada, the net price received by Canadian producers is more or less automatically reduced by 10 per cent. Bilateral free trade then means that such U.S. and Canadian taxes are removed with obvious benefits for consumers and producers alike. But this is just the beginning of the story. If import prices go down, the prices of all import substitutes produced in Canada have to come down also. After all, this was the rationale for having introduced the tariff in the first place: it was to protect Canadian producers, meaning to allow them to charge higher prices behind the tariff wall. With the elimination of the tariff, domestic prices would come down as well as import prices. Furthermore, to the extent that imports consist of producer goods such as machinery or raw materials, tariff removal will reduce costs of production in Canada. Admittedly Canadian tariffs on these products are generally lower than on consumer goods. Nevertheless in several cases where producers might be uncompetitive under present rules, they would become competitive under freer trade. As Ron Wonnacott has said, the present high costs of production in Canada argue in favour of trade liberalization rather than the reverse.

Those price considerations are more a matter of definition than that of genuine impacts deriving from trade liberalization. To turn to these requires an examination of the several studies that have been done focussing directly on expected changes. Free trade produces benefits on four main accounts. The first and traditional one is increased specialization in what a country can do best, given its comparative advantage in terms of factor endowments. By itself, this benefit is not very large, because it assumes constant returns to scale. It is largely recognized, however, that real life involves widespread and substantial economies of scale at both plant and firm level. Indeed, this is common experience: if you produced one car or one book or one shirt instead of a thousand, the cost per unit would be higher. Extending this reasoning, it should become obvious that if Canada with its 25 million people had free and assured access to the 230 million people in the United States, costs of production could be reduced considerably by the size of the market. The more specific sources of gains would be related first, to the pressure of competition which would reduce markups to the extent that economies of scale in a small market implies some monopoly pricing; second, the gains would come from rationalization within industries with the elimination of some products and expansion of other lines as well as the introduction of new products; third, gains would be achieved from longer production runs within much more specialized and larger plants, and fourth, transfers of technology would be made easier leading to further, albeit unmeasurable, gains.

Because others in this conference will cover the ground, I will not review in detail the statistical estimates that have been produced on the gains for Canada from bilateral free trade. Suffice it to say that the aggregate gain in real income or welfare for Canadians has been estimated by Harris and Cox to reach nine per cent of gross national product. This is a very large increase indeed and no other conceivable policy of any kind could ever produce impacts of that magnitude. According to this study and others, free trade does not penalize manufacturing in favour of natural resources. Under free trade, manufacturing does not shrink but expands. This should reassure people and governments in Ontario and Quebec where manufacturing is mainly located.

It must be stressed that the results just given are consistent with several earlier studies by Young, Eastman and Stykolt and Wonnacott. They have also been thoroughly scrutinized by several independent authors such as John Whalley, James Markusen, Ron Wonnacott, Bruce Wilkinson and P.P. Proulx. It is fair to say that everyone has reservations about the estimates, but the approach is seen to be the best one available in incorporating scale factors, the assumptions are reasonable and in any case more acceptable than potential alternatives, so that, overall, one should have sufficient confidence in the results to accept the underlying proposition: bilateral free trade with the United States would serve the best interests of Canadians.

The Potential Costs of Bilateral Free Trade

Such is the case for trade liberalization. It would be nice and easy if I could stop talking at this point. However, economic realities are never so simple and even free trade, I must admit, is not a free good.

The first category of costs associated with trade liberalization are adjustment or transition costs. They are by nature temporary and selective. The essence of the trade liberalization process is a reallocation of resources towards more competitive activities within industries, between industries and to a certain extent between regions. In other words, compared with the status quo, certain activities will be eliminated while others will expand; some jobs will be destroyed and workers will move to other, newly created jobs. The workers displaced will be seen as the losers. I am not sure that the term is the accurate one, to the extent that those workers are likely to get better jobs than the ones they hold. Nevertheless, there is uncertainty involved and generally people hate uncertainty. When job shifting is limited to the same firm or the same industry, it is probably not too serious. Attention is therefore focussed on inter-industry or inter-sectoral changes. The Harris' study quoted above includes an estimate of the expected reallocation of employment between sectors. It amounts to seven per cent of the total labour force in an economy made of 29 sectors. If this were really the case, the burden of adjustment would be rather light and not very much higher than what happens anyway in present circumstances. According to the existing simulations, most sectors gain in value added, productivity and employment. The gains accrue where the U.S. barriers are presently high*, where the Canadian barriers are low, where there are unexploited economies of scale, where export elasticities are high – that is, when demand increases significantly in response to a reduction in price.

Finally, it is interesting to note that labour intensive industries such as textiles and clothing, leather and furniture fare better under bilateral free trade than under multilateral free trade, if one assumes that present tariffs and quotas with third countries remain the same. Some analysts see this as a problem (see P.P. Proulx), insofar as these industries would have to contract again, in the event of multilateral free trade. There are three answers to this: first, if multilateral free trade was a real option, it would be in the interest of Canada to go after it, now; second, if one is really concerned about this double adjustment, nothing prevents Canada from removing its own barriers to trade relative to third countries at the same time as it reaches an agreement with the United States. Third, because of its regional implications, those soft industries being located mainly in Quebec, it is totally unrealistic to expect that one would refuse the benefits from bilateral free trade with the United States in these sectors while bearing the adjustment costs in other sectors.

---

* Some observers argue that the U.S. market is highly protected by non-tariff barriers. The Science Council, for example, quoted an estimate of 34% of manufactured products which would be so protected. The Council then infers that because of that, Canada should be on its guard. Our inference is: the higher the present U.S. barriers, the more gains there are for Canada in getting them removed. (Science Council of Canada. "Placing Technology Up Front: Advising the Bilateral Trade Negotiators". Ottawa, 1986).

A related aspect of the adaptation process is timing. The benefits from trade liberalization presented here may be thought of as medium- to long-term impacts; the calculated benefits apply to an after-the-fact situation, meaning a situation where adjustments have been made and the reallocation of resources has taken place. Since no one questions the fact that adaptation takes time, one can take for granted that any free trade agreement would be phased in over a certain period of time. The minimum would be 5 years and the more likely is 10 years. We heard recently about a 12 year transition period. The prospects are even brighter than that: the United States might accept a 5 year transition for themselves and 10 years for Canada. In any case, taking Canadian tariffs alone, what is involved is the suppression of an average of some 10 per cent spread over 10 years. This is obviously negligible when one thinks of price fluctuations from other sources. What is more important in this respect is opportunities to be seized through investment, distribution networks, line specialization and so forth.

A second category of costs, which is the real source of opposition to free trade, is what can be called harmonization requirements. This is the "hard stuff" giving rise to the wildest speculations because there is no clear established and documented boundary between what is a perfectly legitimate domestic policy and a trade distorting or unfair practice which might be called into question.

Trade distorting practices are the so-called NTBs (non-tariff barriers). Obvious examples are the Buy American Act, Canadian or provincial content requirements, procurement policy, quotas, voluntary export restraints imposed on foreign exporters, export subsidies of all kinds, foreign investment controls, discriminatory taxes, and so on. Those who oppose trade liberalization often state or imply that every policy difference between the United States and Canada will lead to dispute. According to some, even social programs such as health or unemployment insurance would be in jeopardy. The fact of the matter is that to qualify as a NTB, a program must be trade distorting; that is, it must be shown to reduce imports or to increase exports at the expense of foreign producers. A government program can achieve this by direct control over trade or output, through quotas

The Potential Costs of Bilateral Free Trade

Such is the case for trade liberalization. It would be nice and easy if I could stop talking at this point. However, economic realities are never so simple and even free trade, I must admit, is not a free good.

The first category of costs associated with trade liberalization are adjustment or transition costs. They are by nature temporary and selective. The essence of the trade liberalization process is a reallocation of resources towards more competitive activities within industries, between industries and to a certain extent between regions. In other words, compared with the status quo, certain activities will be eliminated while others will expand; some jobs will be destroyed and workers will move to other, newly created jobs. The workers displaced will be seen as the losers. I am not sure that the term is the accurate one, to the extent that those workers are likely to get better jobs than the ones they hold. Nevertheless, there is uncertainty involved and generally people hate uncertainty. When job shifting is limited to the same firm or the same industry, it is probably not too serious. Attention is therefore focussed on inter-industry or inter-sectoral changes. The Harris' study quoted above includes an estimate of the expected reallocation of employment between sectors. It amounts to seven per cent of the total labour force in an economy made of 29 sectors. If this were really the case, the burden of adjustment would be rather light and not very much higher than what happens anyway in present circumstances. According to the existing simulations, most sectors gain in value added, productivity and employment. The gains accrue where the U.S. barriers are presently high*, where the Canadian barriers are low, where there are unexploited economies of scale, where export elasticities are high – that is, when demand increases significantly in response to a reduction in price.

Finally, it is interesting to note that labour intensive industries such as textiles and clothing, leather and furniture fare better under bilateral free trade than under multilateral free trade, if one assumes that present tariffs and quotas with third countries remain the same. Some analysts see this as a problem (see P.P. Proulx), insofar as these industries would have to contract again, in the event of multilateral free trade. There are three answers to this: first, if multilateral free trade was a real option, it would be in the interest of Canada to go after it, now; second, if one is really concerned about this double adjustment, nothing prevents Canada from removing its own barriers to trade relative to third countries at the same time as it reaches an agreement with the United States. Third, because of its regional implications, those soft industries being located mainly in Quebec, it is totally unrealistic to expect that one would refuse the benefits from bilateral free trade with the United States in these sectors while bearing the adjustment costs in other sectors.

---

* Some observers argue that the U.S. market is highly protected by non-tariff barriers. The Science Council, for example, quoted an estimate of 34% of manufactured products which would be so protected. The Council then infers that because of that, Canada should be on its guard. Our inference is: the higher the present U.S. barriers, the more gains there are for Canada in getting them removed. (Science Council of Canada. "Placing Technology Up Front: Advising the Bilateral Trade Negotiators". Ottawa, 1986).

A related aspect of the adaptation process is timing. The benefits from trade liberalization presented here may be thought of as medium- to long-term impacts; the calculated benefits apply to an after-the-fact situation, meaning a situation where adjustments have been made and the reallocation of resources has taken place. Since no one questions the fact that adaptation takes time, one can take for granted that any free trade agreement would be phased in over a certain period of time. The minimum would be 5 years and the more likely is 10 years. We heard recently about a 12 year transition period. The prospects are even brighter than that: the United States might accept a 5 year transition for themselves and 10 years for Canada. In any case, taking Canadian tariffs alone, what is involved is the suppression of an average of some 10 per cent spread over 10 years. This is obviously negligible when one thinks of price fluctuations from other sources. What is more important in this respect is opportunities to be seized through investment, distribution networks, line specialization and so forth.

A second category of costs, which is the real source of opposition to free trade, is what can be called harmonization requirements. This is the "hard stuff" giving rise to the wildest speculations because there is no clear established and documented boundary between what is a perfectly legitimate domestic policy and a trade distorting or unfair practice which might be called into question.

Trade distorting practices are the so-called NTBs (non-tariff barriers). Obvious examples are the Buy American Act, Canadian or provincial content requirements, procurement policy, quotas, voluntary export restraints imposed on foreign exporters, export subsidies of all kinds, foreign investment controls, discriminatory taxes, and so on. Those who oppose trade liberalization often state or imply that every policy difference between the United States and Canada will lead to dispute. According to some, even social programs such as health or unemployment insurance would be in jeopardy. The fact of the matter is that to qualify as a NTB, a program must be trade distorting; that is, it must be shown to reduce imports or to increase exports at the expense of foreign producers. A government program can achieve this by direct control over trade or output, through quotas or domestic content requirements. More often it is done through changing relative prices affecting producers. Export subsidies, for example, will reduce export prices and the impact on trade will then depend on demand and supply elasticities.

Obtaining reliable empirical estimates of actual trade distortions may become an extremely complex matter. One thing is sure: no easy generalizations can be made as to the domestic policies and program which would ultimately be found trade distorting.

Jurisprudence under GATT, the OECD and other international agreements or understandings will be relevant as to what constitutes an unfair or trade distorting practice. Under GATT my understanding is that remission of indirect taxes in the case of exports such as our sales tax or VAT are not deemed to be unfair practices, nor are general subsidies or uniform tax credits applying to rail transportation, electricity or manpower training, although the U.S. Disc provisions were deemed to be unfair (Cline W. p. 343). Canadian regional development programs should be relatively safe, except in those cases, like Michelin, where subsidies are used in fact, if not by design, for exports. Although government procurement practices are obviously trade distorting, several exceptions are allowed under GATT, the OECD, or the EEC, such as in power generation, transportation and telecommunication; Provincial or State Governments would be left alone under those agreements (Cline W. pp. 620-621). Support for research and development, or for the so-called cultural industries would not be at risk, except again where subsidies would clearly fall on exports. (In the latter case, there are wider issues than just subsidies that need attention and caution).

More generally, one has to admit that there are costs and risks in trade liberalization as in any other policy decision. But it is simply not enough to look at the costs without comparing them to the expected benefits. If one businessman says he will have to close his shop in the event of free trade, or an official is saying that he will no longer be able to control this or that, that proves absolutely nothing until the loss is weighed against the benefits.

The Institutional Process

Two brief points before I close. First, why should we expect the most from the present negotiations and be disappointed? Why not instead imagine a minimum and be happy for the time being? In my view it is impossible to resolve now all the issues that would produce a textbook free trade zone with no trade distortions left anywhere in the system and covering every single transaction, public or private. I would even suggest that there are fewer chances of adoption of a very comprehensive and logical scheme than there are of a first step in the right direction. This step would include, first, the removal of all tariffs on manufactured products; second, the removal of the most glaring NTBs which have already been agreed to in existing international agreements; and third, the establishment of a joint authority for the resolution of conflicts and interpretation of the agreement. A transition period of some 10 to 12 years would be specified during which negotiations would be continued to resolve remaining issues.

Second, this gradual approach might also be necessary to get the support of the Canadian provinces in the ratification process. International trade and tariffs are clearly under federal jurisdiction so that Phase 1 suggested above would not formally require the signatures of the provinces. However, if and when NTBs in areas of provincial jurisdiction come up for review, the direct implication and ratification of the provinces will become inevitable. Since this process is likely to take a long time, a relatively quick first step is all the more desirable.

References

Cline, William R., ed. *Trade Policy in the 1980's* (Washington: Institute for International Economics, 1983).

"Placing Technology Up Front: Advising the Bilateral Trade Negotiators." (Ottawa: Science Council of Canada, 1986).

*The Received Wisdom of Canada-U.S. Free Trade: Qualifications**

Randall Wigle

Introduction

In this paper the question of Canada-U.S. free trade is considered in three sections. First, I will summarize the most important elements of what I will call the "received wisdom" about the effects of a comprehensive Canada-U.S. free trade agreement. In the second section I suggest some minor, but important qualifications and clarifications of this body of knowledge. Finally, in section three I make some observations on current events, in the light of my research on this topic.

I. The "Ivory Tower" Economics of Canada-U.S. Free Trade

Perhaps the best known argument about Canada-U.S. free trade suggests that Canada would tend to gain much more from free trade than the U.S. because of the relative size of the countries. International trade theory tells us that when a small economy imposes tariffs, the tariffs primarily affect domestic consumers and producers, making the consumers consume "too few" imports and making the producers produce "too much". When a large economy imposes a tariff, however, there is an additional effect (often referred to as a terms of trade effect), whereby the country imposing the tariff effectively taxes the producers in the exporting country. This occurs because the actions of the "large" economy may affect the prices of traded goods, whereas the actions of smaller countries, in particular, are removed, Canadian producers experience a bonus that U.S. producers do not.[1]

---

* This paper reports some results of previous work with James Markusen.

The second widely accepted proposition is that there are likely to be substantial gains to Canada from industrial rationalization. This very influential hypothesis is usually associated with Eastman and Stykolt (1967), although many others, including English (1964) also understood its importance. In the early 1960s, Canada had a small domestic market, protected by very high tariffs. Canada also had relatively few manufacturing establishments, each of which produced very few units of each of a wide variety of products. This was in contrast to the U.S., where each plant produced a relatively small variety of products, but produced many more units of each. It was argued that one effect of eliminating (or significantly reducing) Canadian tariffs, would be to "rationalize" these industries (primarily manufacturing). The term rationalization refers to the following set of effects:

(i) A reduction in the number of manufacturing plants.
(ii) An increase in the production runs of the remaining products.
(iii) An increase in trade with the U.S. in both directions, due to specialization.
(iv) A significant reduction in Canadian production costs.

Because of both the terms of trade argument, and the Eastman-Stykolt hypothesis, several, though not all authors have estimated that the benefits to Canada from a Canada-U.S. free trade agreement would be very large indeed (on the order of 10 per cent of Canadian GNP).[2]

Associated with the "rationalization" or "Eastman-Stykolt" hypothesis is the possibility that the adjustment to Canada-U.S. free trade would be primarily intra-sectoral, rather than inter-sectoral in nature. This possibility is very attractive for many reasons. First, it would mean that the adjustments to free trade would not be regionally sensitive as if they involved employment shifts between manufacturing, and primary industry (as others had suggested). Also, it is commonly held that inter-sectoral adjustment costs are likely to be dramatically larger than intra-sectoral adjustments, in both economic and human terms. Machinery is more likely to be re-employable, and workers are less likely to need re-training (or experience lengthy unemployment), if the new jobs are in the same or similar occupations to those they have just left. Such would likely be the case if intra-industry adjustment dominated the adjustment to free trade. If this analysis is true, and if Canada-U.S. free trade is likely to be phased in over seven or more years, then the labour market disruption associated with Canada-U.S. free trade is likely to be small.

Finally, and if you have followed me so far you may have anticipated this, the gains to the U.S. from Canada-U.S. free trade are expected by most economists to be insignificant. This follows almost directly from the terms of trade argument concerning the benefits from liberalization accruing to small versus large economies. The rationalization gains from liberalization are also likely to be much smaller for the U.S. because they already have access to a large domestic market, making it possible to achieve low-cost production levels without the need to export.[3] Both of these arguments would suggest that the benefits for the U.S. are likely to be small.

Summary

In summary, it is widely believed among economists that a comprehensive free trade agreement between Canada and the U.S. (involving elimination of all trade barriers) would lead to large benefits for Canada, due to industry rationalization and improved access to the large U.S. market. These gains are estimated by several authors to be very large, particularly when rationalization is taken into account. Further, it is expected that the pace of labour adjustments associated with such an agreement is likely to make these adjustments easily accommodated. Finally, it is widely believed that such a comprehensive free trade agreement would generate negligible benefits to the U.S.

An obvious implication of these results is that Canada could gain from a wide variety of liberalization proposals, but that Canada would have to be somewhat accommodating to interest the U.S. in such an agreement. To turn this statement around a bit, it also follows that Canada can gain from a free trade agreement even if it is sufficiently favourable to the U.S. to make it interesting to them.

II. Qualifications

There are three qualifications or clarifications to this received wisdom that are suggested by my research over the last few years, and I would like to summarize them briefly. If the message of the "received wisdom" is a "pro-free-trade" message, these clarifications do not support an "anti-free-trade" one. I do, however, believe that they change one's perspective about arriving at an agreement which will benefit the U.S. and Canada.

The first clarification of the economics of free trade that I would suggest is that there is a distinct difference between an elimination of all Canada-U.S. tariffs (at their current levels), and a comprehensive free trade agreement, as studied by many economists.[4] My research suggests that the former is unlikely to generate significant gains for Canada, and it could even generate a small welfare loss to Canada. This result has been viewed as heresy in many circles, and I will briefly explain what is behind it. I said earlier that the terms of trade argument suggested that the small economy would tend to gain more from a bilateral elimination of tariffs than the large economy. This proposition should be refined somewhat to read:

> The small economy would tend to gain more from a bilateral elimination of tariffs than the large economy, when the tariffs to be eliminated are of the same height.[5]

Canadian tariffs are, however, significantly higher than U.S. tariffs, and in an important sense, Canada would be giving up more than it was getting in a deal involving just tariffs.

The second clarification that I would make to our beliefs about Canada-U.S. free trade concerns the potential gains for the U.S. from complete free trade with Canada. The received wisdom is that there is precious little in it for the U.S. As I have said before, this follows from two lines of argument. First, the U.S. is unlikely to achieve economies of scale as a result of her expanded market, and secondly, tariffs may actually benefit the U.S. treasury more than they hurt U.S. consumers. My research indicates that there may be significant gains to the U.S. from a comprehensive free trade agreement. My research suggests, (and to be fair, I think a lot of other economists would agree) that there may be significant gains to the U.S. from bilateral free trade, but they are likely to be very small when expressed as a percentage of U.S. GNP, or employment. An important source of these gains is the cost-savings that we all expect to result from Canada-U.S. free trade. When Canadian firms in secondary manufacturing achieve MES levels of production, costs fall. But fully one third of these exports go to the United States, with the result that some of the cost-savings associated with rationalization of Canadian industry are "exported" to the United States.

The final point on which my research has some bearing is on the topic of what I have called the "defensive argument for free trade" (DAFFT). This argument has been put forward by many economists.[6] The argument goes this way:

> Even if the benefits to Canada from a Canada-U.S. free trade agreement are small (which most people who make this argument do NOT believe), the relevant alternative to it, in today's trading environment, is not the status quo, but

rather, a round of protectionism which we know would be very injurious to Canada.

While this point has been made forcefully by many proponents of Canada-U.S. free trade, it has not had the benefit of empirical analysis to quantify the extent of this argument's importance. The results of doing that evaluation can be summarized very briefly:

(i) Both Canada and the U.S. would be better off with free trade than without.
(ii) Canada would be much worse off if a trade war were to erupt between Canada and the U.S. (relative to both the status quo and the free trade outcome).
(iii) The U.S. would be virtually indifferent between free trade and a trade war with Canada. (In other words, the U.S. can gain from a trade war with Canada.)

These findings accord rather well with most economists' intuition, and they reinforce something that we have suspected for a long time. We cannot win a retaliatory trade war with the United States.

Summary

These "clarifications" suggest two alterations to the "received wisdom" about Canada-U.S. free trade. First, the benefits from freer trade for Canada are not so large that virtually any free trade agreement can guarantee benefits to Canada. Second, even though the benefits associated with Canada-U.S. free trade are likely to be modest, the alternative of a retaliatory trade war with the U.S. is extremely unattractive for Canada, even though the U.S. would be virtually indifferent between free trade and a retaliatory trade war with Canada.

III. Comments on Current Events in Light of Some Economic Analysis

Unlike much of the quantitative economic analysis of Canada-U.S. freer trade, the work summarized in part II suggests weaknesses in the positions held by both the proponents of free trade (the Canadian government in particular), and the opponents of free trade (the CLC in particular).

One thing that has become abundantly clear over the last few months is that the process of negotiating a free trade agreement is a process of jostling for position. (I like the analogy to a sprint bicycle race.) The thrust of what I have said so far is that this jostling must be done (given the likely alternative), but it must be done with an eye to making the best of the Canadian position. It is therefore unsettling to know that some of the major moves that could have been used to gain a more attractive deal were gone before the race started. This is unsettling, mostly because I believe it belies the belief by the Canadian government that there are dramatic gains to Canada from free trade, and that the corresponding gains to the U.S. are so inconsequential that the U.S. must be wooed with very attractive terms.[7] I find it even more disturbing that "going into the last lap", the government of Canada recently (March 12-15, 1987) appeared to be declaring victory. My sprint racing analogy is inappropriate for many reasons,[8] but in one sense it may fit the current situation. If someone is ahead going into the last lap of a sprint race, he is almost certain to lose. In bicycle racing this is true because the following rider can benefit from the leading rider's effort to break the wind. I believe it is true in this case because it belies the Canadian government's belief that the potential gains from free trade are unrealistically high.

In the interests of fair play, it is also true that I believe the Canadian Labour Congress (CLC) is displaying muddled thinking on one important aspect of these negotiations. Specifically, their unconditional opposition to free trade appears to be based on the following suppositions:

(i) Unemployment, and related labour market problems are both more important than trade liberalization, and likely to be made worse by a free trade agreement.

(ii) The current trade arrangements with the U.S. are good, and could be retained unchanged. Even problems, like those with cedar shakes and softwood, are better dealt with on a case by case basis, rather than through broad-ranging discussions.

The problem I see with this position is that it ignores the current political environment, and the realities of the importance of trade with the United States. Specifically, the most likely alternative to some type of trade agreement (a serious bout of protectionism) would do more damage to Canadian workers than any free trade agreement likely to emerge. But even if this is not the case (that is that protectionism is not likely to occur if an agreement is not reached), the CLC is very naive to ignore the importance of trade policy in any strategy aimed at reducing unemployment. With such a large share of Canadian production composed of exports, it is irresponsible that any jobs strategy not put outstanding emphasis on our trade relations with the U.S.

Summary

In summary, while it is not true that any deal is preferable to no deal at all, and that bilateral tariff elimination in particular, is likely to be an unattractive alternative for Canada, it is true that engaging in hard-nosed negotiations is preferable to the likely alternative.

Notes

1. The argument is based on the following analysis. Suppose that the price that U.S. goods sell for in Canada is equal to the U.S. price plus the applicable Canadian tariff, while the price that Canadian goods sell for in the U.S. is determined as the U.S. price less the applicable U.S. tariff. If this is the case, U.S. tariffs hurt Canadian producers, and have very little impact on U.S. consumers (or producers), while Canadian tariffs hurt ONLY Canadian consumers, with little (or no) effect on U.S. producers. Under these assumptions, the U.S. tariff becomes a tax on Canadian producers.

2. See, for example, Wonnacott and Wonnacott (1967, 1980), Williams (1978) and Harris (1986).

3. Granted, the rationalization gains would affect Canadian subsidiaries of U.S. firms, but it was felt that the major beneficiaries of the cost reductions in the long run would be the consumers of Canadian-made goods.

4. The latter would involve the elimination of all non-tariff barriers as well.

5. See Markusen (1981).

6. Ron Wonnacott was the first to present this argument to me. Lipsey discusses it in "Will there be a Canada-U.S. Free Trade Association?", in *The World Economy*, 9:3 (Sept. 1986), p. 223.

7. The examples are well known, but the two most crucial "chips" include our drug patent legislation, which was placed out of the reach of the negotiations, and the abolition of the Foreign Investment Review Agency.

8. The major reason that the analogy is incorrect, is that trade liberalization (unlike sprint racing), can lead to a win-win outcome.

References

Eastman, H.C. and S. Stykolt. *The Tariff and Competition in Canada*. (Toronto: University of Toronto Press, 1967).

English, H. Edward. *Industrial Structure in Canada's International Competitive Position*. (Montreal: Private Planning Association of Canada, 1964).

Harris, Richard G. with David Cox. *Trade, Industrial Policy and Canadian Manufacturing*. (Toronto: University of Toronto Press, 1984).

Harris, Richard G. "Summary of a Project on the General Equilibrium Evaluation of Canadian Trade Policy," in John Whalley, ed., *Canada-United States Free Trade*. (Toronto: University of Toronto Press, 1986).

Lipsey, Richard. "Will there by a Canada-U.S. Free Trade Association?", *The World Economy*, 9:3 (Sept. 1986), p. 223.

Markusen, James R. "The Distribution of Gains from Bilateral Tariff Reductions," *Journal of International Economics*, 11 (1981), pp. 553:572.

Markusen, James R. and R.M. Wigle. "Nash Equilibrium Tariffs, and Associated Welfare Gains and Losses." Manuscript, University of Western Ontario, 1987.

Wigle, Randall M. "General Equilibrium Analysis of the Effects of Multilateral and Canadian Trade Liberalization." Unpublished Ph.D. thesis, 1986, University of Western Ontario.

Wigle, Randall M. "General Equilibrium Evaluation of Canada-U.S. Trade Liberalization in a Global Context." Manuscript, University of Western Ontario, 1987.

Williams, James R. *The Canadian-United States Tariff and Canadian Industry*. (Toronto: University of Toronto Press, 1978).

Wonnacott, Paul and Ronald J. Wonnacott. *Free Trade Between the United States and Canada*. (Cambridge Mass.: Harvard University Press, 1967).

Wonnacott, Paul and Ronald J. Wonnacott. "Free Trade Between the United States and Canada: Fifteen Years Later." Centre for the Study of International Economics, Working Paper 8011, University of Western Ontario, 1980.

Canada-United States Free Trade: Economic Realities and Political Choices

Robert A. Young

I. No Deal

There are three options open in the area of Canada-U.S. trade enhancement: to conclude no agreement, a limited agreement, or one covering enough tariff and non-tariff barriers (NTBs) that it deserves to be called comprehensive. In the view of some, to sign no agreement would be disastrous. John Crispo, for instance, has stated that "For Canada to continue to exist as a wealthy industrial society, it must gain secure access to America's large and wealthy market."[1] Simon Reisman, this country's chief negotiator, has put it more flatly still: "Whether Canadians like it or not, the harsh truth is that the only real option available to Canada today is to try to reach a bilateral free-trade arrangement with the United States that would cover all or virtually all the goods and services we produce."[2]

These authoritative statements are supported by several well known arguments which need only a brief summary. Economists focus on the welfare gains to be won through bilateral trade liberalization, often citing an estimate of five per cent to nine per cent of GNP which is derived from the models developed by Rick Harris and David Cox.[3] These gains depend on Canadian industry adjusting to wider markets. And this depends crucially on achieving "secure access" to the American market; that is, an exemption for Canadian producers from U.S. protectionism in the form of countervailing duties against subsidized exports, "safeguard" protection for industries injured by fairly traded goods, and other measures authorized by

Congress or contemplated by its members, who seem increasingly determined to defend American industry. The fear of *lost* exports, profits and jobs now motivates the free-trade initiative more than the expected welfare gains. Canada's primary goal in the trade talks is to gain protection from protectionism, or, as the Business Council on National Issues put it, to "somehow 'get behind' United States non-tariff barriers".[4]

Free-trade advocates also contend that a bilateral agreement in North America could set a salutory example for the multilateral trade talks under the General Agreement on Tariffs and Trade (GATT). On the one hand, accords in new areas like services and intellectual property could show how progress is possible; on the other, Canada and the U.S. could join to crack open Japanese and European resistance on matters like agricultural subsidies.[5] Finally, some advocates regard a trade agreement as a welcome means of disciplining Canadian governments. Many non-tariff barriers are instruments of intervention and industrial policy, and some critics of the state hope the constraints imposed by a treaty on subsidies, protective regulations and discriminatory government purchasing would roll back the activities of both the central and provincial governments. In this view, the pathologies of politics lead to interventions which defend established interests rather than promoting adjustment, so forced harmonization of the Canadian policy environment with that prevailing in free-enterprise America would produce a more efficient, market-driven economy.[6]

My own arguments against concluding a bilateral free-trade agreement have been laid out elsewhere.[7] This case as presented originally rested on the economic costs of adjustment, the medium-term consequences of adapting not according to some idealized comparative advantage but to the niches left by American industrial and governmental power, and the long-term contraction of Canada's trade diversity and of this country's latitude for autonomous decision-making, both of which would inevitably accompany greater continental economic integration. To these basic arguments in favour of the "no agreement" option, it suffices to add here only a few supplementary points.

First, the evidence is mounting that the predicted GNP gains from Canada-U.S. free trade were highly optimistic. One model has found regional gains to be far lower than expected; careful empirical work has shown that the all-important economics of scale are not realizable to the extent envisioned; and the Harris-Cox specifications of pricing behaviour and the magnitudes of existing NTBs are questionable.[8] Summing up the emerging contradictory findings, Wilkinson has concluded that they "are largely the result of variations in assumptions processed through sophisticated programs.

At most they tell us that we do *not* really know in any detail what the industrial consequences of BFT (bilateral free trade) might be."[9]

As for the secure-access argument, two points stand out. First, the protectionist bark has been worse than the bite. According to one compilation, between 1980 and 1985 the U.S. International Trade Commission (ITC) found against Canadian producers in 1 of 9 countervail cases, 4 of 20 anti-dumping cases, and 8 of 14 unfair practices cases; as well, the International Trade Administration has set modest levels of punitive duties.[10] Over the same period, only 0.9 per cent of Canadian exports were subject to countervail.[11] It is true that softwood lumber has since been added to the list, that steel has been sideswiped by measures aimed at other producers, that potash is threatened by an anti-dumping action, and that safeguard measures have affected industries like sugar and shakes and shingles. Nevertheless, compared to the profits accruing from rising exports, the costs of fighting the cases and the penalties imposed have been very low.

Despite this reality, the proponents of free trade are fully engaged in the politics of fear. While they accuse the anti-free traders of fearmongering and of grossly exaggerating an agreement's impact on employment, culture and sovereignty, their own rhetoric is becoming more extreme. The obvious intent is to mobilize interests in support of a deal by magnifying the perils which American protectionism may bring. This prospect cannot be ignored. But neither should we fail to recognize it for what it is – a threat.

Whether the alternatives to a free-trade deal are viable depends in part on the force of protectionist pressure in the United States. This will decline as the sliding American dollar helps redress that country's trade imbalance by increasing exports and cutting demand for imports. Despite the clear intent of both the ITC and Congress to broaden the definition of what constitutes an unfair subsidy, it seems now that the 1987 trade bill will be less threatening than those proposed in 1986. The Democrats want not to be perceived as purely retrograde protectionists, and much of the emphasis in Congress is shifting towards positive measures to strengthen competitiveness and win access to foreign markets.[12] This, then, is precisely the wrong time to negotiate an agreement which will endure for decades.

Hence, one alternative is the "hunker down" strategy. This involves riding out the storm, absorbing some blows against particular industries and dodging others. During the Nixonomics episode in 1971, Canada absorbed such blows through passing the Employment Support Act to assist affected firms. That Act still on the books. Obviously this country cannot finance a protracted trade war with the U.S. Yet retaliation worked in the shakes and shingles case, and in other sectors like potash and newsprint, American customers are both dependent on Canadian supplies and fairly concentrated: unless one presumes that Congress and the ITC are irrational enough to ignore importers and consumers entirely, then the current degree of Canadian-American economic integration should moderate protectionism in many sectors. The other part of this strategy is to "track" the evolving U.S. trade law. Canadian governments would simply abstain from any policies and programs declared unfair by Congress and the ITC. Most "unfair" programs would have to be abandoned anyway under a trade agreement as part of the price of gaining secure access. Voluntary restraint could accomplish the same object, without forever alienating sovereign rights. Whether American safeguard measures could be avoided through similar restraint on the part of Canadian business is unclear. Steel is not an encouraging example. But the principle remains: self-discipline in the short run could substitute for a permanent agreement.

The second part of an alternative strategy is to rely on the multilateral system, which has been Canada's principal guarantee of access to world markets, including that of the United States. Free-trade advocates maintain that the GATT system is weakening, that the process is slow, and that a Canada-U.S. agreement could serve as a model and a stimulus for new negotiations. The multilateral system is indeed fragile, due to protectionism, massive capital flows, and structural problems in the U.S., Japan and the EEC. As Lester Thurow warned, "the current degree of economic integration has outrun the world's collective political willingness to manage it."[13] This, however, should make Canada *more* interested, not less, in working within the GATT. A separate bilateral deal can be seen by our GATT partners as a vote of non-confidence by Canada in the multilateral system, especially when part of its domestic appeal lies in the chance it offers to displace third-party competitors from the American market.[14] Indeed, the bilateral alternative can be seen as an effort by the United States at once to threaten Japan and the EEC and to provide insurance should the attempt fail: if the U.S. cannot achieve freer multilateral trade on its terms, it may substitute for a system where it is no longer the hegemonic power a set of bilateral arrangements, each one of which it can dominate.[15] Canada is merely next in line, moving to the fore because of its extraordinary trade dependence and vulnerability.

The GATT is making progress. The September 1986 meeting at Punta del Este agreed to insert agriculture and services in the next round of negotiations, and set a four-year target for concluding the round. Yet Canada's efforts remain concentrated almost entirely on the bilateral talks. Rather than negotiate alone to keep markets open, is it not sensible to operate multilaterally, joining the U.S. to prod Europe and Japan to open their markets, and joining the others to fight American protectionism and retain access to the U.S. market under clear rules? In the bilateral arena, Canada's bargaining position is weaker and less flexible. Moreover, a bilateral deal would remove multilateral support permanently. If North American rules and a joint dispute-resolution mechanism were established, U.S. actions against Canada would shift out of the purview of GATT rules and agencies. "Canada would be isolated in a one-on-one situation with the United States. . . . Without the constraint of a possible appeal to a GATT panel, U.S. officials would have considerable latitude in interpreting obligations and rights."[16]

Finally, there remains the ideological argument for a treaty which would constrain Canadian governments from indulging in inefficient industrial policies. This motive has emerged more clearly over the last few years. As André Raynauld put it, "So much the better if free trade makes Canadians more aware of the consequences of their policies; so much the better if our external obligations force us to see that we have an interest in being productive and competent, rather than life pensioners."[17] At the abstract level, extreme forms of this view can be condemned as contemptuous of democracy. Its adherents advocate introducing by subterfuge constraints which they see as necessary but which the Canadian public has been unwilling to impose on its elected representatives. There is good evidence not only that direct government interventions have been less widespread and inefficient than is often claimed, but also that they reflect genuine mass preferences.[18]

More practically, recent analysis suggests that the neo-conservative agenda cannot be realized through a bilateral trade deal. On the Canadian side, Bruce Doern has shown how continental free trade may well require an expanded state, rather than one which is rolled back and scaled down.[19] In America, even under Mr. Reagan, there is an industrial policy, one which works through the Pentagon, and this is far less likely to be bargained away than are Canada's more visible industrial and regional subsidies. Whether the Republicans or the Democrats capture the White House in 1988, this industrial policy will probably be broadened, as it has been at the state level, for pragmatic reasons.[20] Hence, many sectors of Canadian business would face a tough competitive struggle against policy-driven American firms. If equity prevails, Canada's government could retain considerable leeway for wasteful interventions; if, as seems more probable, equity does not prevail then Canada will have an industrial policy made in Washington.

We will return in Part III to the scope which a free-trade agreement may allow for Canadian economic and industrial policies. Here, it is enough to conclude that the arguments representing a bilateral deal as imperative, or even as desirable, are readily contestable. Canada does have options: one is not to proceed with a free-trade treaty with the United States.

II. A Limited Deal

The second possible option is to reach a limited agreement to liberalize bilateral trade. In 1986 I tried to lay out several reasons why the Mulroney administration might find this outcome attractive.[21] The example used then was a deal covering government procurement only, though one can conceive of other pacts which cover tariffs or NTBs like subsidies and customs regulations, or which are limited to several sectors, or which merely establish bilateral agencies. Until early 1987, it seemed likely that the outcome of the negotiations would indeed be one or a series of such limited deals, and it is worth examining the argument briefly.

A government procurement treaty (GPT) would eliminate domestic preferences in the purchase of goods and services by governments. It would open large new markets to Canadian firms, while the Americans would gain access to a relatively larger public sector market; hence there would be gains, and symmetrical ones. A GPT would not weaken the GATT but would build on the existing procurement code, and other nations could join as signatories. Compared to a comprehensive deal, a GPT would create less pressure to harmonize a wide range of domestic policies which affect trade. It would neutralize one instrument of industrial policy, but there would be few backwash effects on other instruments arising from the need to create a homogenous competitive environment – the famous "level playing field". This would reduce nationalist opposition, as would the exclusion by irrelevance of sensitive sectors like culture. Finally, a GPT would create few obvious and organized losers, and their opposition would have little legitimacy since no one has a permanent right to sell products to governments.

The strategic attraction of such a limited agreement, or a set of them, rested upon a number of assumptions. It seemed that a comprehensive accord was unlikely for several reasons. The most important was that Congress would never accede to the key Canadian demand, an exemption from existing trade laws about contingency protection. "Congress", I agreed, "will not surrender its authority over the U.S.A.'s largest bilateral trade flow, and allow disputes to be settled by new, neutral institutions buffered from aggrieved domestic interests." This obstacle would halt the considerable institutional momentum, originally provided by business seeking secure access, which carried the initiative forward. Equally compelling was the rising domestic resistance to a comprehensive treaty. This was expressed by both opposition parties, the trade unions, some provincial governments, affected interests in sectors like agriculture, and nationalists both within and without the cultural industries. Opinion polls showed support for free trade to be waning. And the declining popularity of the government, centred around a lack of trust in the prime minister himself, suggested that the Mulroney administration risked losing power if it attempted to force through a comprehensive deal in a decisive, climactic struggle over the fundamental issue of continentalism versus national sovereignty. Once begun, however, the trade talks had to produce some tangible result. Otherwise face would be lost, Canadian business would gain nothing, and the U.S. side would be further irritated by Canadian ambivalence about a prospect which the U.S. Trade Representative has said should cause "dancing in the streets in Ottawa." As David Leyton-Brown put it, "Depending on the degree of failure, Canadian retrenchment could range from a return to the status quo ante to a period of severe tension. At best there would be a normal, arms-length relationship, but at worse there would be bitterness, resentment and hostility."[22]

It seemed that the likely product of this complex of forces would be a limited agreement to liberalize trade in circumscribed areas. Such a pact, perhaps followed by others, might initially cover most tariffs, the more overt industrial subsidies, and procurement, and it would establish a new bilateral agency along the lines of the International Joint Commission, to investigate trade disputes and make non-binding recommendations about resolving them.[23] This result is still possible; indeed, it is the most likely outcome. But within the first half of 1987, the prospects of a far more comprehensive agreement seem to have improved considerably. The negotiators are discussing a very wide range of topics, the premiers have been muted in their criticism, Mr. Reagan has put the issue high on the American agenda, and Mr. Mulroney seems to have crossed the Rubicon, stating that "the choice is ours for all Canadians, and personally, I have made mine."[24] The proponents of free trade have become much more optimistic. Why is this so? Have there been changes in the considerations which made a limited, incremental deal seem probable?

First, it may be that business interest in a free-trade agreement is such that nothing short of a comprehensive deal would satisfy it. Canadian sales to the United States have continued to rise, especially in finished products, where protection was most sought in the past. Excluding products under the Auto Pact, exports of inedible end products to the U.S. rose 74 per cent between 1982 and 1986, and they surpassed exports of crude materials for the first time ever in 1984.[25] Businessmen have gained confidence in their ability to compete, they fear the prospect of exclusion from the American market, and a long phase-in period for tariff reductions provides reassurance.

Arguably, the leading elements of Canadian business have never viewed the Americans as a threat, but these interests are now more coherently organized than ever, jointly with the executives of major American subsidiaries, in the Business Council on National Issues. The BCNI articulates the collective, long-term interests of large private-sector corporations, and it strongly supports trade enhancement. One can suggest other reasons, both structural and conjunctural, for the near unanimity among businessmen in support of free trade. These include the shock of the 1981-82 recession, the rising proportion of both sales and assets in the U.S., and the increasing concentration of firms into conglomerates capable of internalizing cost-benefit calculations of free trade's effects (and of silencing the losers, which if independent would have mounted resistance). But the sheer commitment at the ideological level and its enforcement by peak business organizations cannot be neglected as a factor.[26] It is almost heresy to speak against the trade initiative. As in the cases of the NEP, the Benson White Paper on Tax Reform, and Quebec independence, even firms which may lose by adopting the consensus position do not oppose it overtly, but seem content to suggest minor embroidery on the pattern of implementation.

If business remains firmly behind the free-trade initiative, the opposition to it may be decreasing. This resistance arises from several sources, among which are those interests expecting to suffer from bilateral trade liberalization. Trade unions, led by the Canadian Union of Public Employees and the Canadian Auto Workers, have mounted well-organized campaigns against free trade. On the other hand, new efforts by proponents of the initiative to amplify the threats of protectionism have mobilized potential losers among those who have reason to fear cuts in export markets. Hence, labour is by no means unanimous on the issue. Where workers have been stung recently by countervail and safeguards, as in steel and lumber, their unions have moved to support free trade.

Another significant locus of opposition is in the provincial capitals. If we can presume that B.C., Alberta, and Saskatchewan will support any deal from which agriculture is excluded and that the Atlantic provinces will do the same if transfer payments, equalization, and regional development funds continue to be available, then Ontario and Quebec are the central players. Each of these governments naturally is subject to the same free-trade forces which animate Ottawa, but each also has particular concerns. The issues for Quebec are hydro exports, the soft sectors like textiles, and the state's continued ability—despite the neo-conservative pronouncements of Mr. Bourassa and his advisors—to implement an active industrial policy in support of the new Quebec entrepreneurial class. Ontario must be concerned with the last issue too, for it has been considerably more activist than many analysts allow, but its main preoccupations are the Auto Pact and what American subsidiaries will do should tariff protection cease. It is in Ontario as well that the cry for secure access to the U.S. market is strongest.

Currently, the stance of both provincial administrations is a cautious one. They appear to be allowing the Mulroney administration room to manoeuvre and to bargain. In contrast to the truculent statements of 1986 about their ability to veto bilateral arrangements, each premier seems prepared to let the initiative carry through to a concrete set of proposals. Of course each has other concerns.

Another, deeper reason for the non-confrontational attitude of these premiers is that a more realistic appreciation of their bargaining power may have sunk in.[27] It is undeniable that provincial governments can frustrate central-government treaty arrangements by refusing to implement the necessary legislation to remove NTBs in their areas of jurisdiction. Unlike the case in the U.S.A., where treaties and some executive agreements have direct applicability, and the trade and commerce clause has been interpreted by the courts in favour of the central power, the Canadian provinces are paramount in their jurisdictional fields. But the central government has formidable weapons insofar as the current negotiations are concerned. In particular, it is entirely within Ottawa's power to eliminate all tariffs immediately. This would weaken the Auto Pact (to which Ottawa is the signatory in any event). It could also produce the withdrawal of multinational subsidiaries which Ontario fears might happen over time. Apart from tariffs, the central government retains jurisdiction over energy exports, banking, and foreign investment, powers which provide Mr. Mulroney with considerable leverage over Ontario and Quebec in the federal-provincial negotiations about trade. Moreover, there are clear signs that Ottawa will try to sell a free-trade deal as a redistributive, regional-development measure. As in other respects, this represents an excuse not to take positive action and instead to deploy free trade as a panacea. (It suffices to see the irony in a prime minister proclaiming that "we are in the process of building two Canadas, one which is rich and promising and one which is underdeveloped and unemployed."[28]) Still, given the aggravating regional disparities in employment and incomes, central-Canada-bashing may give the initiative a boost. Messrs. Peterson and Bourassa may have good reason to be subdued.

Apart from the provinces and the obvious winners and losers from a free-trade deal, the other important source of opposition is general public opinion. As is well known, public support for the free-trade initiative has slipped substantially as the issue has risen on the policy agenda. Yet Canadian opinion about such matters revolves around two core attitudes – the general sentiment towards the United States and its influence on Canada, and the economic impact which a changed relationship might have. On the first dimension, the distribution of views seems fairly stable over time. Canadians regard the U.S. as our closest ally; they also tend to think that it has too much influence on this country.[29] This is consistent with the Decima Research interpretation which suggests Canadians prefer a close but proper, or businesslike relationship with the U.S.A., and perhaps an agreement which establishes a bilateral agency could be presented as consistent with this image of formal partnership.[30]

On the economic side, Richard Johnston has argued in a study for the Macdonald Commission that Canadians are "pre-eminently concerned with job creation and protection". The public does support abstract declarations about competitiveness; in "more concrete cases, however, most Canadians seem protectionist."[31] On the other hand, Johnston also found the public willing to temper these sentiments when jobs were thought to be at stake. As well, when attitudes towards macro-economic issues were explored, he found that Canadians have "rather weak information about the future of the economy and hold, at best, rather soft opinions on specific instruments which might affect that future."[32] The conclusion was that public opinion is based both on self-interest and on concern for the country as a whole, but that Canadians "are preoccupied with economic results, with ends more than with means."[33]

What does this imply? It suggests that the downward trend in public support for free trade may not reflect a definitive swing but rather an underlying uncertainty about the effects of freer trade. The real story of the change in public opinion could be that it is changeable. After all, support for free trade has declined from its 78 per cent peak to around 52 per cent, but only after rising from a 1983 figure of about 40 per cent.[34] Although the public has mixed feelings about the United States, there may be room to persuade Canadians to support free trade not only because it would improve their individual economic welfare but also because it would strengthen the country as a whole. This opens the opportunity for the government to represent anti-free traders as narrowly selfish groups concerned only with preserving their special advantages, a tack it is sure to take in defending either a limited or a comprehensive agreement.

On the American side, major changes have also taken place. The issue of Canada-U.S. free trade, like others, must be seen in the contexts of larger American concerns and the new power relations between the President and Congress. First, the administration has moved the issue higher up the policy agenda. Mr. Reagan has been politically enfeebled by the Iran-Contra affair, and has few attainable policy objectives for which to strive in the remainder of his term. A trade deal so ardently sought by a trusty ally offers an attractive opportunity for historical accomplishments.

The capacity of Congress to do other than react to narrow, defensive, constituency pressures may in any case have been overestimated. For many members, the deployment of protectionist measures and of threats to enforce the rules of "fair trade" may be as much a tactic in a larger game as a knee-jerk response to constituency demands. In the past Congress has proven itself capable in the end of advancing the long-term national interest of the Union. It suffices to recall Lend-Lease, the Marshall Plan and, more relevant, the Alaska purchase of 1867.

All this could mean that the American side may be prepared to move after all on the key Canadian demand for relief from U.S. trade remedy legislation. At first, the American position on this issue was quite intransigent. The U.S. Trade Representative said the proposed exemption was a "non-starter" and the U.S. ambassador said Canada's hopes in this area were "unrealistic".[35] Congress would be terribly reluctant to delegate its authority over America's largest trade flow. It did not do so in the case of Israel, despite the small volume of trade involved, Israel's strategic importance, and the presence of a strong pro-Israel lobby in the U.S. But much depends on the precise mechanism through which the exemption would work.

Some officials believe that if tariffs are eliminated, then anti-dumping measures can be abandoned, because dumped goods can be shipped back and sold in the country of origin and because antitrust policy could handle cross-border predatory pricing.[36] As for countervail, proposals have been made to establish a bilateral agency which might gradually assume de facto binding authority through the evolution of precedent.[37] Some such suggestions are wildly optimistic in that they fail to specify what would happen when the authority of a new joint agency conflicts with Americans' legal right to an ITC ruling.[38] It does seem conceivable that countervail could be largely eliminated as a threat to Canadian exporters, were a new subsidies code both comprehensive in scope and detailed in its provisions. But there are always shadowy areas needing interpretation as well as violations requiring enforcement, so Congress would still be asked to delegate authority to the new, joint agency.

More important, the area of safeguard remains, under section 201 of the 1974 Trade Law which permits tariffs or quotas to be imposed when rising imports seriously injure American industries. Even if these imports are fairly traded, protection is quite legitimate under GATT's article XIX, which allows countries to "escape" normal rules, and which enshrines the sovereign right of states to defend their producers. Congress would be most hesitant to override the right of domestic industries to petition for relief from Canadian imports. As an aide to Senator John Heinz (Pennsylvania, Republican) put it recently, "We would be strenuously and unalterably opposed. We can't take away the rights of American individuals to seek redress under the administrative proceedings we now have."[39] Beyond these problems lies the power of the President to retaliate against violators of trade commitments, as well as several other provisions in existing law about agricultural imports and threats to national security, and Congress's authority to pass laws at any time to deal pragmatically with trade problems. Asking Congress to exempt Canadian exporters from these various provisions is demanding little short of a revolution in U.S. trade law.

Yet two developments can be noted on this front. First, the Canadian government continues to press its key demand, with increasing clarity and obduracy. Mrs. Carney, minister for International Trade, said in March 1987 that the government would sign no agreement which would continue to let Canadians be held "hostage to the unpredictable whims of American protectionism."[40] The prime minister told American reporters bluntly that "the trade remedy laws cannot apply to Canada, period."[41] Similarly, business opinion remains firm and united in Canada: as Ronald Anderson wrote, without relief from U.S. contingency protection, "the trade agreement could deliver nothing that would give substance to the visions of the free traders."[42] Like the statements of certain senators, this may be a bargaining tactic; for the government it may also leave open an exit route from the talks.

But on the other side, there has been some movement. Both Senator Bentsen (Texas, Democrat) and Ambassador Niles have indicated the U.S. is prepared to listen to Canadian representations and suggestions about secure access.[43] The door is not entirely closed either in Congress or the administration. The Americans are open to offers, and given the importance to Canada of this critical demand, they can expect generous proposals. Shortly, I will argue that the trade-off for secure access may lie in the area of investment. The key point, however, is that Congress might move to grant Canada's exporters their prized relief from contingency protection. This raises the possibility of a comprehensive agreement, because the essential difference between a limited deal and a sweeping one lies in secure access *and* in what Canada is willing to concede to get it.

One last factor in the set which will determine the scope and provisions of a free-trade agreement has changed little recently. The Mulroney government's political fortunes continue to be depressed. The Tories' popularity is low, even for an administration three years into its term, and the prime minister's perceived credibility and trustworthiness have not improved. A free-trade deal requiring a leap of faith – rather than a hop – will need persuasive explanation by leaders who can draw on public confidence.

III. A Comprehensive Deal

In the House of Commons trade debate on March 16, 1987, Mrs. Carney listed the following topics as under negotiation in the Canada-U.S. talks: tariffs, quotas, protectionist standards, discriminatory procurement policies, customs procedures, agricultural matters including tariffs and health standards, subsidies, the protection of intellectual property, trade in services (notably engineering, financial consulting, computer services and banking), and, finally, investment. "So far", she said, "we are dealing only with trade-related investment matters. The Americans want more."[44]

Indeed the U.S. side undoubtedly does want concessions on the investment front, and herein could lie the core of a basic trade-off underpinning a truly comprehensive trade agreement. The essence would be to concede secure access to Canadian exporters in return for national treatment of American capital. The free movement of goods would be exchanged for the free movement of capital.

As the negotiations come down to the crunch, it seems that the access-investment nexus, if solidified, will form the cornerstone of a comprehensive agreement.

What, then, would such an agreement contain? What might a comprehensive Canada-U.S. trade agreement really look like? It would begin with the main elements of the limited deal discussed above – tariffs to be phased out, simplified and harmonized customs procedures, a subsidies code specifying permissible direct aid to industry, a declaration that negotiations will continue toward fuller liberalization of trade in services, an end to discriminatory procurement policies, and the establishment of a new joint trade agency.

The comprehensive agreement, however, would deepen integration of these areas. Tariffs would include agricultural products, customs procedures would need strict enforcement of rules of origin, and there could be provision for jointly collecting trade data. Were countervail to be effectively renounced by both sides, the subsidies code would have to be very detailed, with permissible exceptions – agriculture, small business, national defence, remote and highly underdeveloped regions – clearly identified, and with the methodology for calculating the trade effects of subsidies entirely clarified. Some service-sector agreements would be included: initial candidates are those where regulation is neither intense nor shared between levels of government and where employee migration is minor, such as data processing. But many obstacles to service trade would fall as a consequence of agreements about procurement and the entry of capital. On the procurement front, exceptions would be minimized and the states and provinces would be included, either through their agreement or through a commitment to make federal grants conditional on non-discriminatory purchasing practices. Last, the bilateral agency would have extensive investigative powers and more authority to settle disputes not only about the application and extension of the treaty provisions but also about the use of contingency protection. The straightforward delegation of full powers might be avoided in two ways. The agency could make final decisions in cases where small volumes or percentages of trade are involved; alternatively, decisions could be subject to parliamentary and congressional and/or presidential over-ride.

A comprehensive deal would leave several areas untouched: most of the agricultural support system, grants for some regional infrastructure, and assistance to cultural industries (though these would be narrowly defined, to include news magazines, for example, and to exclude trade journals and commercial printing). It is probably that the Auto Pact would be left intact, though falling tariffs would diminish its impact and the Canadian system of duty remissions to attract foreign manufacturers may end.

In other areas, a comprehensive agreement would go far to eliminate what the Americans call "irritants". On intellectual property, Canada would very likely remove copyright differences as well as pushing through changes in pharmaceutical patent protection. Tough negotiations on the cultural front would likely see the replacement of regulatory protection with direct subsidies: this would involve ending cable-signal piracy (or the "simultaneous substitution" of Canadian commercials), along with the protection afforded border broadcasters and Canadian magazines under the tax laws.

Finally there is the investment issue. A range of possibilities exists here. Canada could guarantee national treatment to American-owned firms already operating in this country, ceasing all discrimination against them and relieving them of performance requirements of the kind required by the Foreign Investment Review Agency and Investment Canada or currently negotiated as Memoranda of Understanding by the Department of Regional Industrial Expansion.[45] Beyond this, the right of establishment could be extended to American firms starting new operations in Canada. This would not be incongruent with the Mulroney government's general attitude toward new job-creating investment. Even further, free entry could be conceded to U.S. companies intent on buying out Canadian firms, directly or indirectly. With respect to American capital, in short, Investment Canada could be entirely neutralized. Or it could continue to review cases of great magnitude or those arising in particular sectors like publishing and telecommunications.

These are large concessions, especially since national treatment of incoming capital is not now extended by the United States, where foreigners entering some sectors face a minefield of regulations and restrictions. Hence, Canadian exceptions could mirror those prevailing south of the border.[46] Or, American restrictions under the control of Washington could be ended for Canadian firms. In either case, there is asymmetry since Canadian capital poses no threat whatsoever to Americans' control of their economy. Nevertheless, if the U.S. side is to move on contingency protection, which is the key Canadian goal, Canada needs to reciprocate elsewhere. Especially if the cultural industries are to continue receiving protection and support, then nothing short of very significant liberalization of existing restrictions on capital flows seems capable of generating the desired movement.

How, then, will Canadians assess the desirability of a comprehensive agreement which takes this form? The social policy question can be dispensed with quickly. An agreement would impose constraints only indirectly, through the Canadian political process. First, there would be freer entry into some sectors like health services and hospitals, which would broaden the mix of significant interests represented in the relevant policy communities: pressure to amend programs could result. Similarly, there could be a de-unionization trend in both the public and private sectors, through greater competition in industries like construction and through new pressures to increase contracting-out. This, however, is no necessary consequence of an agreement: it is an internal matter subject to policy choice. Second, and more broadly, an agreement would increase the competitive pressures on all Canadian firms, and this could lead to stronger demands for relief from payroll and other taxes that increase business costs to support social programs. The main threat to social programs, in short, would be internal complaints, not externally imposed constraints. The effect would simply be to sharpen the attack on existing programs which is bound to occur in any event as a consequence of heightened exposure to the world economy.[47] Indeed, insofar as Canada would become more highly integrated with the relatively inefficient American economy, the effect on social programs would be less severe than would result from, say, more Canada-Pacific Rim trade.

The cultural dossier is a more complex one. Many Canadians, especially on the periphery, have little sympathy for policies which protect rich, eccentric publishers operating from Toronto townhouses. There is also widespread hesitation to endorse measures which restrict freedom of choice in listening, viewing and reading material according to its national origin. On the other hand, Canadians have a right to know themselves, and whatever one presumes to be the ultimate engine of national unity—economic ties, institutional arrangements, or cultural identification—no one can doubt the immediate impact on behaviour of the last and the consequent stakes in preserving Canadian culture. Cultural industries are also characterized by significant scale economies such that in Canada, to the extent they contain indigenous content, they are likely to be infant industries forever.

Presumably, a comprehensive agreement will allow considerable scope to governments to support the cultural industries (narrowly defined). This would fulfil public promises by Mr. Mulroney and various ministers. It is also congruent with Ottawa's recognition that Canadians will need reassurance that "sovereignty" as embodied in national identity has not been compromised by the deal.[48] On the other hand, the U.S. side will likely insist that measures restricting the entry of cultural materials and the operations of foreign subsidiaries in the industry be ended. In other words, positive subsidization of Canadian culture will continue, but restrictions on American culture will be dismantled.

This brings us to the economic repercussions of a comprehensive agreement. With respect to real costs and benefits, most analysts seem fairly sanguine. The major anticipated impact is seen as flowing from tariff reductions, which would be gradual in highly protected sectors and which, in any case, would be less significant than a currency appreciation of around 15 per cent. It is clear, though, that costs will be imposed on some sectors, and there remains the likelihood of U.S. subsidiaries winding down their operations in Canada. These losses would be balanced to some degree by growth through fresh investment and rising exports in other sectors. It is also possible that a new comprehensive system of social security and retraining could ease adjustment costs (and buy out political opposition using some of the gains expected to materialize). But the net economic effect of any Canada-U.S. agreement is imponderable. It depends too much on factors extraneous to the accord itself, including decisions of a multitude of private actors and changes in the overall world political economy.

What is far more significant is whether Canadian governments will retain the capacity in the future to influence private decision and respond to external changes; that is, to implement industrial policies. In the grossest terms, this capacity will be reduced, unavoidably, because any agreement will heighten North American economic integration and increase American leverage over Canada. Already this leverage in the form of the threat to close markets has brought

Canadians to the bargaining table, after having discarded important bargaining counters like the Foreign Investment Review Agency. To believe that an "impartial", "non-political" joint agency will, in the crunch, insulate Canada from this power is simple foolishness.[49] But within these ultimate parameters of American dominance, would the provisions of a comprehensive agreement limit recourse to necessary industrial policies?

Much depends on what is necessary. We may eliminate as unrealistic some proposals for full-blown industrial planning of the European socialist variety, though paradoxically some of its main elements like nationalization and more government spending would not be precluded by a comprehensive deal.[50] At the other extreme, those who view the economy as successfully adjusting now, and advocate therefore only simple, non-discriminatory measures like tax incentives to increase investment, would sense no constraint in a comprehensive agreement.[51] Yet even those at the very non-interventionist end of the spectrum could be forced to oppose a comprehensive deal were it to contain provisions limiting monetary and exchange-rate policy. The ultimate device for absorbing and moderating competitive disequilibria, in this view, is currency devaluation (which, though this is less often discussed, does impose heavy costs on some). Were a Canada-U.S. agreement to specify exchange-rate limits, so establishing a "mini-snake" joining the currencies, this mechanism would be unavailable. Even the staunchest free-trade proponents admit this constraint would be unacceptable.[52]

But most analysts fall between the extremes of laissez-faire and dirigisme. Joseph D'Cruz and James Fleck, for example, have argued that secure access is important, but that governments must also follow a coherent set of policies in managing Canada's "industrial portfolio". Will the constraints imposed in order to win secure access eliminate the possibility of pruning and nurturing?

Industrial policy generally refers to sector- or firm-specific interventions. What are the implications for Canadian industrial policy of national treatment and of increased foreign ownership of Canadian manufacturing? Rick Harris, here representing the mainstream view of economists, regards foreign direct investment as benign and beneficial for its technology-transfer effects, and advocates no discrimination against subsidiaries when supportive programs are implemented. Others disagree, basing their arguments on the relatively low R&D effort of subsidiaries compared to parent firms, their weak export performance, their tendency to purchase services from parents, and the ultimate outflow of dividends.[53]

It is clear that a comprehensive agreement, minimally, would prohibit Canadian governments from negotiating with American firms performance guarantees in the form of agreements to purchase Canadian products, transfer technology, maintain employment, reinvest, do R&D, export goods, or acquire world product mandates. Even if agreements covering some such activities were negotiated with all firms in a sector as a matter of course, rather than only with foreign subsidiaries, it would be hard to argue that all companies received equal or "national" treatment since the agreements would be firm-specific. Moreover, with a treaty guarantee of autonomy in hand, U.S. subsidiaries would be less likely than they are at present to adhere to "voluntary" or informal arrangements such as Harris's export cartels or D'Cruz and Fleck's government-led oligopolies in the commodities sectors.

Insofar as firms are responsive to governments in general, it is hard not to conclude equally generally that parent companies and their subsidiaries must ultimately respond most to the government of their home country (or that in which firms have sunk most capital, economic and political). So one must agree broadly with Molot that "high levels of American ownership of Canadian industry have impeded the ability of the federal government to make and implement national policy decisions."[54] More American investment, therefore, would render national economic policy more difficult to formulate and to enforce, whenever that policy diverges from U.S. policy.

Of course this proposition is debatable. So are many others which have been advanced about the effects of foreign investment.[55] But no amount of empirical testing of past economic reality will determine the choices Canadians will make about bilateral free trade. Foreign investment could, it seems, play a significant role in the free-trade debate – as will other economic aspects of any new agreement – but the ultimate decisions will be made in the political arena, and it is there to which we now return.

IV. Conclusion

Canadians have three different options about bilateral free trade. I would rate the chances of there being no deal as very low; similarly, a comprehensive deal seems improbable. The outcome of the talks is likely to be a limited package of agreements, as depicted in Part III above.

The reason for this lies in the Mulroney government's political fortunes, though the basic causes are much deeper, having to do with what is politically possible in Canada, given the economic, social and cultural fabric of the country. It is certain that the New Democratic Party will oppose any Canada-U.S. deal, because it will in their view entail adjustment costs and lost sovereignty. Yet the prime minister's image and popularity are such that his party alone cannot build an adequate consensus to support a comprehensive free-trade agreement. The Tories could attempt a kamikaze manoeuvre, signing such a deal in the knowledge that electoral defeat would follow. But the Red Tories in the Cabinet who have doubts about the initiative as it is, and others with a strong instinct for political propriety (or for electoral survival) would resist. As well, against two determined opposition parties capable of obstructing all parliamentary business and of whipping up public resistance, the government could not implement such an agreement. It is conceivable that a plebiscite on trade could save the government and perhaps the initiative by removing the issue from its association with the Tories, while also avoiding parliamentary deadlock. But again, facing a resistance led by two united parties the comprehensive option would very probably fail to command a majority.

No, if the Mulroney administration is to push through a deal, there is only one avenue open. That is to produce an agreement which splits the Liberal party. Currently the Liberals can dodge and shift on the issue. They avoid their obvious internal divisions by attacking the government's strategy and tactics, while advancing only the vaguest of alternative goals. A Liberal position paper of mid-1986 nicely illustrates this: "In the process of reacting to someone else's initiatives, honest answers cannot be reduced to simplistic slogans. If asked 'Are you for free trade?', the answer is 'no, if you mean the Mulroney government approach to trade policy' . . . If the question is 'Are you for a good trade relationship with the U.S.?', the answer is 'Yes. . .' "[56] As the issue comes down to the crunch, the internal differences have become harder for the Liberals to paper over. These are not matters of mere personality, but of a perennial division within the party between national determination and continentalism, one perhaps more difficult to surmount when in opposition than when in power.

When an agreement emerges, the luxury of attacking the process rather than the product will end abruptly. An agreement will be no more open to amendment in Canada than under the American fast-track procedure, and the Mulroney government will present the deal in the starkest possible terms: take it or leave it. If enough Liberals are prepared to take it, then the government, in coalition as it were, might manage to sustain public opinion in favour of the agreement.

But if Canada concedes the right to restrict U.S. investment in vital sectors like energy, manufacturing, banking, informatics, publishing and health services, then public apprehension about a literal sellout would rise enormously. And the Liberal party would not be divided, for they could not resist getting out in front of public fears and spearheading them. Not only would failure to do so concede too much policy space to the NDP, but foreign investment is also too symbolic in the party's past and economic development planning too essential in its future. In reality, capital may have neither home nor loyalty, but the Liberals, like most Canadians, would agree that any development policy beyond a simple faith in international market forces requires the ability to foster, to favour, to guide, and certainly to preserve a national business community.

This analysis suggests that the government is indeed near the brink in the free-trade talks. If a comprehensive agreement hinges on the trade-off between secure access for goods and unimpeded investment flows, then it cannot be sold in Canada. If the talks are broken off, then Canada would be exposed to the full ire of the Americans, who were asked to negotiate, after all, and who might place no more credit in their special relationship with Canada. The most likely alternative is for the government to draw back and to settle—assuming the Americans would agree—for a limited deal. This will meet neither the core demands of Canadian business nor the expectations of the U.S. side, but it may be just tolerable politically. In any case, Canadians will pay for their government having invested so much time and effort pursuing the chimera of winning access to the American market on Canadian terms.

Notes

1. John Crispo, "The Case for Free Trade with the United States", in, *Canadian Trade at a Crossroads: Options for New International Agreements*, eds. David W. Conklin and Thomas J. Courchene. Ontario Economic Council Special Research Report (Toronto: OEC, 1985), pp. 308-317: 312.

2. Simon Reisman, "Canada-United States Trade at the Crossroads: Options for Growth", Conference Board of Canada, *Canadian Business Review* (Autumn 1985), pp. 17-23: 19.

3. Canada, Royal Commission on the Economic Union and Development Prospects for Canada, *Report*, Vol. 1 (Ottawa: Supply and Services, 1985), pp. 229-30.

4. BCNI, "The Canada-United States Trading Relationship and the Idea of a Trade Enhancement Agreement" (September 1984), p. 2. See also Canada, External Affairs, Statements and Speeches, No. 85/26, "Towards a New Trade Agreement With the United States", Statement by Rt. Hon. Joe Clark to the Foreign Policy Association, New York (November 18, 1985), p. 2.

5. Tom Hockin, Address to the Political Science Students' Association, London (March 5, 1987).

6. See, for example, Thomas J. Courchene, Two Cheers for Free Trade, MS (April 1986).

7. R.A. Young, "Last, Worst Deal", *Policy Options*, 6:6 (July/August 1985), pp. 4-9.

8. Elizabeth Beale, Trade Flows Between Atlantic Canada and the United States, presented to the Atlantic Canada Economics Association, Sackville, New Brunswick (October 24, 1986); P. Rao and M. Daly, Free Trade, Scale Economies and Productivity Growth in Canadian Manufacturing, presented to the Canadian Economics Association, Montreal (May 31, 1985); Randall M. Wigle, General Equilibrium Analysis of the Effects of Multilateral and Canadian Trade Liberalization, Ph.D. thesis, University of Western Ontario (December 1985), esp. pp. 44-109, 117-137.

9. Bruce Wilkinson, Canada-United States Free Trade: Setting the Dimensions, presented to a conference on the Political Economy

of Canada-United States Free Trade, Carleton University, September 25-26, 1986, (revised October 31, 1986), p. 13.

10. Alan M. Rugman, U.S. Protectionism and Canadian Trade Policy, presented to a conference on Canada-U.S. Free Trade: Bilateral and Multinational Perspectives, Provo, Utah (April 4, 1986), pp. 11-21.

11. Chong-Hyun Nam, "Export Promoting Policies Under Countervailing Threats: GATT Rules and Practice", World Bank Discussion Paper, Report No. VPERS9, (Washington: December 1986), Table 4.

12. Giles Gherson, "U.S. Import Bills Posing New Threat to Trade Pact", *Financial Post* (April 6, 1986), p. 4.

13. Lester Thurow, "America, Europe and Japan: A Time to Dismantle the World Economy", *The Economist* (November 9, 1985), pp. 21-26: 21.

14. R.J. Wonnacott, *Canada/United States Free Trade: Problems and Opportunities*, Ontario Economic Council Special Research Report (Toronto: OEC, 1985), pp. 9-10.

15. Albert Breton, The Political Economy of Free Trade, presented to the Atlantic Canada Economics Association, Sackville, New Brunswick (October 24, 1986).

16. M.G. Clark, "Nontariff Measures: Perceptions and Reality", in *Canadian Trade at a Crossroads*, eds. Conklin and Courchene, pp. 265-287: 274.

17. André Raynauld, "Trade Deal, or As We Are", *Policy Options*, 8:3 (April 1987), pp. 16-18: 18. The Macdonald Commission made the point most clearly: "The explicit premise behind our free-trade proposals is that the Canadian economy must be made more competitive, and that domestic adjustment-retarding policies must be replaced with adjustment-facilitating strategies. Our basic international stance complements our domestic stance. We must seek an end to those patterns of government involvement in the economy which may generate disincentives, retard flexibility, and work against the desired allocation of resources." (*Report*, Vol. 1, 50.).

18. André Blais, *A Political Sociology of Public Aid to Industry*, Royal Commission on the Economic Union and Development Prospects for Canada, Research Study No. 45 (Toronto: University of Toronto Press, 1986).

19. G. Bruce Doern, "The Tories, Free Trade and Industrial Adjustment Policy: Expanding the State Now to Reduce the State Later?", in *How Ottawa Spends 1986-87: Tracking the Tories*, ed. Michael J. Prince (Ottawa: School of Public Administration, Carleton University, 1986), pp. 61-94.

20. James D. McNiven, American Economic Policies in the 1980s; Trends, Levels, and Implications for Canada, MS (February 1987).

21. R.A. Young, "A Way Out for Mr. Mulroney", *Policy Options*, 7:4 (May 1986), pp. 3-8.

22. David Leyton-Brown, "The Mulroney Gamble", *International Perspectives* (September-October 1985), pp. 27-30: 30.

23. R.A. Young, The Political Economy of Canada-U.S. Free Trade, presented to the Atlantic Canada Economics Association, Sackville, New Brunswick (October 24, 1986).

24. Martin Cohn, "No Time for Timid, Says Mulroney – Free Trade Deal with U.S. 'Urgent' ", *Toronto Star* (March 13, 1987), A-1.

25. Canada, Statistics Canada, *Summary of External Trade*, cat. 65-001 (Ottawa: Supply and Services, various years), Tables M-3 and X-3.

26. For an interesting attempt to work through these issues, see William G. Watson, "Canada-U.S. Free Trade: Why Now?", *Canadian Public Policy*, forthcoming.

27. R.A. Young, "L'Ontario et la fédération libre-échangiste", in *Un marché, deux sociétés? Libre-échange et autonomie politique*, eds. Christian Deblock and Maurice Couture (Montreal: ACFAS, 1987), pp. 141-150.

28. Canada, *House of Commons Debates*, Vol. 129, No. 87 (March 16, 1987), p. 4147.

29. Canadian Institute of Public Opinion, *The Gallup Report*, July 4, 1985: in response to the question "Which country do you regard as Canada's best friend?", the proportions choosing the U.S.A. were 58 per cent, 75 per cent, and 69 per cent in 1965, 1980, and 1985 respectively. See also the *Report* for November 11, 1985: in 1974, 57 per cent of Canadians felt the U.S. has too much influence; in 1985, 58 per cent thought so.

30. Edison Stewart and Alan Ross, "Ottawa was Warned U.S. Ties too Chummy", *London Free Press* (March 7, 1987), A-1.

31. Richard Johnston, *Public Opinion and Public Policy in Canada*, Royal Commission on the Economic Union and Development Prospects for Canada, Research Study No. 35 (Toronto: University of Toronto Press, 1985), pp. 183, 187.

32. *Ibid.*, 119.

33. *Ibid.*, 144.

34. *Ibid.*, Table 5-28, and Donna Dasko, "Canadian Public Opinion: Sources of Support and Dissent", in Duncan Cameron, ed., *The Free Trade Papers* (Toronto: Lorimer, 1986), pp. 26-32: 27.

35. *Globe & Mail*, November 8, 1986, A-5.

36. Canada, Trade Negotiations Office, "Regulating Anti-Competitive Pricing Practices in a Free Trade Area", n.d. but March 1987.

37. Frank Stone, "To Avoid Trade Disputes", *Policy Options*, 7:5 (June 1986), pp. 19-22.

38. Alan Rugman, "Countervail Must Die With Trade Pact", *The Financial Post* (March 23, 1987), p. 8.

39. Jennifer Lewington, "Washington Infighting Poses Risk to Trade Talks", *Globe & Mail* (March 23, 1987), B-1.

40. Canada, *Debates* (March 16, 1987), p. 4180.

41. John F. Burns, "Mulroney Sees U.S. Trade Pact", *New York Times* (April 3, 1987), p. 26.

42. Ronald Anderson, "Access to U.S. Market Essential in Any Free-Trade Arrangement", *Globe & Mail* (March 24, 1987), B-10.

43. Hon. Thomas Niles, Address to the McGill University North American Studies Conference on Canadian-American Free Trade (March 19, 1987).

44. Canada, *Debates* (March 16, 1987), pp. 4177-4180: 4179.

45. Paul Stothart, "Performance from Subsidiaries", *Policy Options*, 8:1 (January 1987), pp. 33-37.

46. Ontario, Ministry of Industry, Trade and Technology, *The Implications of National Treatment in a Free Trade Agreement*, Ontario Trade Studies #1 (n.p., November 1986), pp. 14-19.

47. Tom Courchene, *Social Policy in the 1990s: Agenda for Reform*, C.D. Howe Institute, Policy Study No. 3 (Toronto: C.D. Howe, 1987).

48. Mary Janigan, "A Secret Plan For Free Trade and Sovereignty", *Maclean's*, 98:45, November 11, 1985, pp. 14-16. See also Jennifer Lewington, "Ottawa Will Plan on Sovereignty in Seeking Support for Trade Deal", *Globe & Mail* (March 9, 1987), A-1.

49. See the comments of a senior official in the Canadian ministry of Justice, reported in Giles Gherson, "'Bold New Trade Vision' Raising Some Eyebrows", *The Financial Post* (April 13, 1987), p. 10.

50. John Calvert, *Government Limited* (Ottawa: Canadian Centre for Policy Alternatives, 1984), especially pp. 115-153.

51. Roy A. Matthews, *Structural Change and Industrial Policy: The Redeployment of Canadian Manufacturing, 1960-80*, study for the Economic Council of Canada (Ottawa: Supply and Services, 1985).

52. John Crispo, "The Case Against Critics of Free Trade", *The Financial Post* (February 8, 1986), pp. 15-16.

53. See, for example, John Britton and James Gilmour, *The Weakest Link*, Science Council of Canada, Background Study No. 43

(Ottawa: Supply and Services, 1978), and Patricia Marchak, *In Whose Interests* (Toronto: McClelland and Stewart, 1979).

54. Maureen A. Molot, "The Political Implications of North American Capital Flows", in *The Integration Question*, eds. Jon H. Pammett and Brian W. Tomlin (Toronto: Addison-Wesley, 1984), pp. 163-81: 163.

55. A.E. Safarian, *Foreign Direct Investment: A Survey of Canadian Research* (Montreal: Institute for Research on Public Policy, 1985).

56. Liberal party policy paper, n.t., n.p. (August 8, 1986).

What Do Economists Know About Free Trade?

Tim Hazledine

Introduction

The Macdonald Commission (1985) reported as the "mainstream view" amongst "competent" Canadian economists the prediction that free trade with the United States would generate "substantial" increases in Canadian GNP, in the range of 4 to 10 per cent.[1] In this paper I will not contest that many[2] competent Canadian economists do indeed believe that free trade would add enormous sums – tens of billions of dollars – to our gross national product. But I will argue, first, that the consensus is shaky in that a number of their own studies actually offer much smaller estimates; secondly, that the assumptions required to generate the big numbers are empirically unsound; and, thirdly that new data – which I will introduce in the paper – on relative Canada/U.S. price performance imply that the likely scope for productivity improvements due to tariff cuts is much less than could plausibly coexist with very substantial free trade benefits.

The implication to be derived from all this is not that free trade would not in fact generate some efficiency improvements, as promised. I believe that it probably would. But the likely figure is well within the reasonable range of error of economic models. We should not be surprised if we are wrong, especially since the "competent professionals" should admit that their training has instilled in them a strong ideological bias in favour of free trade.

All this is rather worrying if economists' rosy forecasts of the gains from free trade are being used by the trade negotiators or their political masters to justify significant concessions to U.S. interests in order to achieve an agreement.

Measurement without Data: The Free Trade Gain Estimates

Attempts to quantify the potential gains to Canada of trade liberalization go back at least 30 years, to J.M. Young's (1957) comparison of 1954 Canadian and U.S. prices for 13 categories of goods. Attributing the higher Canadian prices to Canadian tariffs, Young estimated the cost to consumers to be between 3.5 and 4.5 per cent of private expenditure.

Since tariffs now are well below one half, on average, of their 1954 levels, and since some, at least, of Young's "cash cost" is just a transfer from consumers to producers – that is, not an efficiency loss reducing Canadian GNP – his method would seem likely to come up with quite small free trade gain estimates if applied today.

However, Young's "factual" approach, using real data to compare the performance of the Canadian and U.S. economies, did not establish a precedent. Instead, subsequent work on free trade has followed what Markusen (1985) calls a "counterfactual" methodology, asking "what if" questions, and answering them with the aid of assumptions about market behaviour which do not usually have well-tested empirical foundations.

For 20 years the leading standard bearers of this method have been Ronald and Paul Wonnacott, who were the first to climb the psychologically important "10% peak" – that is, to predict free trade benefits as high as 10 per cent of Gross National Product. They achieved this (1967) by adding to Young's approximately 4 per cent consumer cost figure an additional 6.5 per cent obtained by assuming that free trade would raise both Canadian wages and the Canadian dollar from their actual (1958) levels to parity with the United States.

The actual mechanism for generating these large numbers is a "black box", not set out analytically, but the Wonnacotts are, with Eastman and Stykolt (1967), partially responsible for an important tradition in Canadian economics, which focusses the blame for allegedly poorer productivity in Canada on inefficient plant scale, and attributes this to tariff protection.[3]

One or both of the Wonnacotts have refined their estimates from time to time (1975, 1982), but the most exciting recent development in the game of asking "what if" questions has undoubtedly been the arrival on the scene of the "General Equilibrium Trade Model" of Richard Harris and David Cox (1984; Harris 1985). Harris and Cox open up the black box and show us, in some detail, just how a model based on scale economies can generate predictions of major efficiency gains from free trade. Their estimate for the Macdonald Commission is that U.S./Canada bilateral free trade would raise Gross National Expenditure in this country by nine per cent.

The Harris-Cox model has been quickly and widely acclaimed. In my opinion, the model certainly deserves high praise as an innovative and creative step towards introducing elements of imperfect competition into the field of general equilibrium modelling. But I believe that the model's application to Canada/U.S. free trade should be interpreted as a pilot study, rather than as a polished piece of empirical work providing triumphant confirmation of the earlier estimates of big free trade gains, as it seems to have been taken.

Part of the problem is that most of the data used – estimates of elasticities, and so on – are not reliable enough to bear the weight put on them, and part of it is that, although the idea of building imperfect competition into a model is in itself good, the particular implementation of the idea by Harris and Cox is idiosyncratic.

I have set out my reservations in detail elsewhere (1984b), but can here note the two major areas of controversy.

First, Harris and Cox get their big potential for productivity improvements by assuming that some observed correlations (due to Gupta and Fuss, 1979) between unit costs and size of plant within Canadian manufacturing industries imply opportunities for small firms to reduce costs by rationalizing into larger units, and for already large plants to become even more cost-efficient by expanding further.

While some unexploited scale economies no doubt exist, it seems implausible to assume that these are available freely and to all firms, and without limit. In most (54 of 91) of Gupta and Fuss's industries, minimum efficient scale is in fact estimated to occur at two per cent or less of industry output, and in nearly one third of their sample the estimated relationship is actually U-shaped, implying diseconomies of scale beyond some optimal plant size. In addition, it can be argued that some of the success of larger firms should be attributed to rents accruing to non-replicable factors such as superior management. If so, then consolidating small firms into larger units, or pushing already large operations to expand further, would decrease, not increase cost efficiency.

As an example of what is involved in getting the Harris-Cox scale efficiency numbers, note that a large chunk of these are predicted to come from a more-than-doubling of the output of the important Transportation Equipment industry, which, of course, has already been subjected to extensive rationalization over the last 20 years as a result of the Auto Pact.

The second big problem, in my opinion, arises from the way in which imperfect competition is introduced into the model. Firms in the Harris-Cox model are (partially) able to collude to take advantage of tariff protection by raising prices, but they are supposedly unable to collude either to effect a rationalization of the assumed inefficiencies in plant sizes, or to prevent entry of new firms from wiping out higher profits due to tariff-inflated prices.

That is, all the rents from tariff protection get dissipated in higher costs rather than being pocketed as fatter profit margins, which is precisely why eliminating tariffs can have such a striking effect on productivity, by forcing efficiencies onto the industry.

This is an unusual model of oligopolistic behaviour. My reading of the Industrial Organisation literature is that both theory and evidence support a more moderate hypothesis, which grants oligopolists some success (to an extent possibly depending on market concentration) in preserving their ill-gotten gains from the depredations of competition, while suggesting that, over the long term, they will adjust their plant size and other factors to take advantage of profitable opportunities for improving production efficiency.[4]

If so, the gains from free trade will be less than Harris and Cox predict, both because some of the adjustment to loss of protection can be absorbed in the "fat" of above-competitive profit margins, and because the potential for achieving cost reductions is less than their scale economy assumptions imply. In this connection, see the papers by Wigle (1987 and in this volume), which report much smaller free trade gain numbers from a model designed to be quite similar to that of Harris and Cox.

It should be noted that Harris and Cox have been scrupulous about performing sensitivity analyses, which show their numbers varying widely in response to changes in the assumptions made about pricing behaviour, scale elasticities, and demand elasticities (eg., 1984 pp. 117-21), and have expressed concern about the need for better empirical estimates of the key parameters in their model. Their ongoing work with John Lester's group in the Department of Finance is incorporating, among other things, more sophisticated scale economy estimates, and they have been supportive of my own research aimed at extending and updating my earlier (1980) econometric results on the impact of tariff protection on domestic pricing behaviour.

Yet many economists seem set on pushing the big numbers for free trade gains. This is seen even when their own work implies something much more moderate. John Whalley, in his role as coordinator of the free trade research for the Macdonald Commission offered the 4-to-10 per cent of GNP figure even though his own research (which he did not cite) with Bob Hamilton (1985) came up with a much smaller number—just 0.6 per cent of GNP. James Williams writes that:

> Canadian empirical work since the second world war indicates that free trade with the United States would increase GNP by 7-10.5 percent (1986, p. 2)

but his (1976) model, which, like Hamilton and Whalley's assumed constant returns to scale, predicted less than one third as large a figure.

There is also a sort of piggy-back effect, whereby authors borrow bits of each others' research, thereby achieving what superficially looks like an impressively broad-based consensus, but which in fact is built on a rather smaller body of independent results. The Wonnacotts, for example, have used the figures of Young and of Williams, and the Economic Council of Canada, bringing the weight of its vast CANDIDE model to bear on the free trade issue (1986, chapter 3), makes rather a nonsense of the whole exercise by blithely *assuming* a five per cent improvement in manufacturing productivity, based loosely on the scale inefficiency estimates of John Baldwin and Paul Gorecki, rather than properly building the productivity change process into the model.

To summarize the situation; we by now have a mixed bag of "what-if" or counterfactual analyses of the impact of free trade, of which the most powerful and impressive, by general agreement, is the work of Harris and Cox. However, the current usefulness of the latter is severely curtailed by its relatively weak empirical underpinnings – by the dearth of relevant factual analysis.

Now, this situation might seem rather puzzling. After all, over the last few decades there have been substantial reductions in the height and coverage of Canadian tariffs, exceeding in their size the remaining liberalization possible with bilateral free trade. Why have not these reductions been linked empirically to change in productivity? Note that most of the productivity gains have to come from the manufacturing sector, and that this accounts for only 20 per cent of gross national product. Thus a 5 per cent increase in GNP implies a more than 20 per cent increase in productivity performance in manufacturing, and an even larger impact on the industries within manufacturing which would bear the brunt of the burden of adjustment.

Numbers of this size should jump right out of the historical data, if they in fact exist. Yet there appears to have been no successful effort to relate tariff cuts under, say, the Kennedy Round of the GATT, to improvements in productivity at the industry level. The Wonnacotts in fact presume on such effects when they revise downwards their estimate of the remaining gains from free trade, and claim that this actually strengthens their case by "illustrating the benefits that it (free trade) can bring" (1982, p. 413), but their supporting footnote mentions only productivity improvements due to the *Auto Pact*, which is an example of industrial policy, not free trade. Indeed, one of their tables shows no change in relative Canada/U.S. productivity between 1971 and 1981 – the period over which the Kennedy Round tariff cuts should have had their effect.

Manufacturing performance over this period has in fact been analyzed in enormous detail by Baldwin and Gorecki, using the Statistics Canada "micro" database, which permits analysis of behaviour within individual industries. But, although they uncover many interesting correlations, and successfully relate changes in protection to changes in the various scale-related variables (such as length of product run) posited to be the instruments of productivity improvements, they were apparently not able to show that the tariff changes in fact delivered these improvements (1986, chapter 7).

Some New Data on Canada/U.S. Price Performance

In this section I report some direct comparisons of performance in the Canadian and United States manufacturing sectors. The approach is really a throwback to the "factual" methodology of Young (1957), who calculated the potential for lower Canadian prices as a result of tariff cuts by comparing prices here with those in the United States.

The procedure is to search for commodities in each country's Census of manufacturing industries which seem to be similarly defined, and for which both (factory gate) value of shipments and quantity of shipments are available. By dividing value shipped by quantity we get a measure of the manufacturing wholesale price of the commodity in each country.

The comparisons were made for 1977 and 1982, these being the most recent years for which U.S. data were available. For those years, we[5] were able to match 231 commodities, from 100 (Canadian 1980 SIC) four-digit manufacturing industries. The value of shipments of these commodities covered about 40 per cent of the 1982 value of shipments of the 100 industries, which in turn accounted for about three quarters of the total shipments of the Canadian manufacturing sector. As well as unit values (prices), data on imports, exports, duties paid, and some industry-level market structure variables were also collected.

To summarize the information, each commodity was assigned to one of five categories, or "codes", as follows:

code 1: "comparative advantage" commodities of which Canada exports more than 20 per cent of its output to the U.S., while imports (from the U.S.) take less than 5 per cent of the domestic Canadian market;

code 2: "intra-industry trade" commodities, for which trade between the two countries is relatively balanced. This category includes commodities for which both imports and exports are small, if there are no substantial tariff or transportation barriers blocking trade;

code 3: "comparative disadvantage" commodities, of which Canada exports less than 5 per cent of domestic output, and for which imports from the U.S. supply more than 20 per cent of local market requirements;

code 4: "blockaded" commodities, for which non-tariff barriers prohibit or severely restrict any imports;

code 5: "naturally protected" commodities, for which high transportation costs effectively rule out significant trade flows in either direction.

Note that, in keeping with our focus on Canada-U.S. trade relations, it is Canada's trade position vis-à-vis the U.S., not with the World, that is used to sort the commodities into codes.

Table 1 shows values of some calculated variables for each code, and for the full sample of 231 commodities. The first two columns give the number of commodities in each code, and their share of total (231-commodity) shipments. The intra-industry trade group is much the largest, with more than one half the total number of commodities and shipments. This group represents a wide range of manufacturing activities.

There happens to be the same number of commodities in each of the comparative-advantage and disadvantage groups, but the share of total shipments of the latter code is much less. This is not all surprising—it is to be hoped and expected that we put relatively more resources into making the things that we are relatively successful at, as evidenced by ability to export more than we import. Comparative-advantage commodities are concentrated in the resource-based sectors—paper, wood, primary metals—whereas the disadvantaged group includes commodities from clothing, footwear, as well as other manufacturing industries.

The two trade-restricted codes, 4 and 5, contain a smaller number of commodities, but are not therefore insignificant. The food and alcoholic beverage commodities that make up code 4 account for nearly 10 per cent of the total shipments of the code 5 group (including such commodities as ready-mix concrete, bread, and soft drinks) have more than 7 per cent of shipments.

The next two columns are the most important, showing average ratios of Canadian to U.S. prices for the commodities. The averages are calculated using 1982 Canadian shipments as weights, and with prices converted into common units with an exchange rate of 1.03 in 1977, and 1.21 in 1982.

Table 1
Weighted Means of Variables

	1	2	3	4	5	6	7	8	9	10	11
	Number of Commodities	Share Manufac. Shipments 1982	Relative Can/US Price 1982	Relative Can/US Price 1977	Ratio Exports/ Domestic Shipments	Ratio Imports/ Domestic Market	Ratio Duty/ Dutiable Value	Ratio Dutiable Total Value Imports	Ratio US Imp./ Total Imports	4-Firm Seller Conc. Ratio	% Shipments US-Controlled
code 1	37	0.144	0.965	0.986	0.523	0.011	0.076	0.751	0.814	53.3	25.3
code 2	129	0.627	0.908	0.943	0.214	0.160	0.086	0.267	0.796	66.7	54.8
code 3	37	0.057	1.073	1.054	0.007	0.129	0.101	0.898	0.587	51.1	32.4
code 4	16	0.099	1.285	1.258	0.001	0.020	-	-	0.895	49.6	23.8
code 5	12	0.073	1.020	1.090	0.008	0.005	-	-	1.013	34.8	14.3
all industries	231	1	0.971	0.997	0.211	0.111	0.085	0.395	0.812	59.9	43.2

See text for definition of codes.

Columns 3-11 use each commodity's 1982 shipments as a proportion of total shipments in its code as the weight.

Code 1: "comparative advantage" commodities
Code 2: "intra-industry trade" commodities
Code 3: "comparative disadvantage" commodities
Code 4: "blockaded" commodities
Code 5: "naturally protected" commodities

What are we looking for here? If Canada is a "small" economy, and if tariffs are passed through into domestic prices, we would expect Canadian prices to exceed U.S. prices by an amount equal to the tariff, on the assumption that the large U.S. market can be taken as the "world" (exogenous to Canada). This is the "law-of-one-price", which has prices of the "small" country's output set equal to the tariff-inclusive price of competing imports from the world.

Then, if tariffs were eliminated in a free trade deal, we could expect, as do the economists supporting free trade, that domestic market prices would be reduced, and productivity improvements forced upon Canadian industries (unless the exchange rate quickly depreciated to restore balance, in which case prices would go up in some industries, and down in others, and there would be no need for an across-the-board improvement in productivity).

Are our relative price numbers consistent with this model? No they are not. Overall, the wholesale price of trade manufactured commodities was *lower* in Canada than in the United States in both years – the weighted average of relative prices for codes 1 through 3 is 0.929 in 1982 and 0.958 in 1977. Either U.S. firms reduce their supply price to the Canadian market to absorb our tariff, or Canadian firms do not take advantage of tariff protection to raise their prices to the Canadian market price of imported goods, which should equal the U.S. price plus the Canadian tariff.

The first possibility does not seem very likely, if only because Canadian firms would cry "dumping" if their U.S. competitors supplied goods to our market at less than the domestic U.S. price. The second alternative does not rule out domestic prices being lower still in the absence of tariffs, but it does seem to rule out any simple "law-of-one-price" equating of domestic prices to tariff-inclusive import prices, and so requires that we find out rather more about the workings of domestic pricing behaviour before making predictions about the impact of free trade.

In fact, I have done some preliminary econometric work with this database, and found some support for earlier research with a smaller sample (1980), which revealed an "Eastman-Stykolt" relationship between seller concentration ratios and the industry's ability to take advantage of tariff protection in the form of higher prices and profit margins. But the extent of this price-inflating effect of tariffs appears to be substantially less than is assumed in the models that predict large welfare gains from free trade.

Note that the absence of a price effect does not mean that tariff protection is useless to domestic firms, but rather that they benefit in the form of higher market shares (as imports become relatively more expensive) rather than higher profit margins.

There are some interesting differences between the codes. Comparative advantage commodities are priced, on average, a little below the U.S. price, which is enough to enable them to export a large fraction (column 5) of their production. These tend to be relatively homogeneous, resource-based commodities for which differences in prices between sources of supply are likely to be arbitraged away. In such markets, something like a unique "world" price is likely to obtain, and Canada's market share will be determined more by cost than demand considerations. These are not, on the whole, the type of commodity likely to be produced under conditions of increasing returns of scale, and they are not, therefore, expected to contribute much to any free trade increases in Canadian GNP.

It is the large group of intra-industry trade commodities on which are pinned the hopes for specialization and scale economies in a free trade environment. Such productivity improvements may indeed be forthcoming, but it is surely a little disturbing that factory prices in 1982 were nearly 10 per cent lower in Canada than the Canadian-dollar price of U.S. goods, even before adding the tariff (averaging 8.6 per cent—see column 7) to the latter.

Note that not much more than one quarter of the imports from the U.S. of these commodities was actually subject to tariff duties in 1982 (column 8). This proportion should be even lower now, after five years of implementation of the Tokyo Round of the GATT. Note too that the industries producing these commodities tend to be relatively highly concentrated (column 10), and show a relatively extensive degree of U.S. ownership or control (column 11).

The code 3, comparatively disadvantaged group do look vulnerable to loss of tariff protection, since their prices in 1982 were about seven per cent above U.S. prices—a ratio that actually increased from 1977, despite the large depreciation of the Canadian dollar over the period. That is, the industries producing these commodities are performing poorly and getting worse.

However, their shipments amount to less than six per cent of the total, and the relatively low ratio of imports from the U.S. to imports from all sources (column 9) warns us of the possibility of wasteful "trade diversion", should tariffs on U.S. imports be removed while those levied on other countries (plus the various quotas on clothing imports from developing economies) are left in place.

The various agriculture-based industries which are granted immunity or a privileged position with respect to import competition (code 4) reward us by charging prices nearly 30 per cent higher than prices in the U.S. There can be little doubt that if access to these markets was opened up as a result of a free trade deal, domestic firms would be forced to sharply reduce their costs or lose a large part of their market.

Finally, the code 5 commodities – those virtually insulated from import competition by transport costs – provide a sort of control group. They tend to be produced in Canadian-owned industries with relatively low entry barriers, and so give us an idea of how fairly "competitive" Canadian industries perform in the absence of imports. In 1982 Canadian and U.S. prices in this category were just about equal, on average.

To summarize: at the exchange rate of 1982 Canadian traded commodities cost about seven per cent less than U.S. commodities – a price advantage which no doubt is reflected in the substantial trade surplus (compare columns 5 and 6) of that year. This does not mean that Canadian manufacturers have higher physical productivity than U.S. suppliers[6], but it does seem to make it difficult to find a substantial role for tariffs, and thus for trade policy, in the pricing process.

Conclusion

I have argued that the productivity gains from free trade with the United States, which the Macdonald Commission expected to be the "most important" benefit to Canada (1985, p. 325), are likely to be much smaller than the free trade enthusiasts would have us believe. The economic studies in fact reveal quite a wide range of predictions, and the only fully worked-through analysis to come up with the very large numbers – that of Harris and Cox – includes several fairly extreme assumptions which are likely to bias upwards its free trade gain figures.

We also have the circumstantial evidence of the "dog that didn't bark" – that is, the curious lack of any studies in the literature identifying productivity gains arising from the very substantial tariff cuts that Canada has experienced through the Kennedy and earlier Rounds of the GATT. Perhaps this just reflects lack of interest (reprehensible enough in itself), but I am inclined to suspect that the job has been tried, the answers found inadequate, and then, given the bias against publishing "negative" results, the research quietly shelved. Whatever the truth of the matter, this is surely a useful area for further research, and we have begun work on this at the University of British Columbia, with the collection of a detailed database covering the commodities most affected by the Kennedy Round.

Finally, there is the tentative evidence of the Canada/U.S. price comparisons introduced in the previous section. Whatever will be the eventual findings of econometric analysis of these data, it seems most unlikely that they can be consistent with the tariff-determined pricing model that is needed to get big free trade numbers.

None of this means that there would be no efficiency gain from free trade. I still expect that there would be,[7] but find it hard to believe in numbers bigger than one or two per cent of GNP.

Now, even one per cent of GNP is a lot when expressed in billions of dollars, but it is not a lot compared with the likely range of error of economic forecasts, and that is the point. All this talk of productivity gains may even seem rather dated, given the new worries about access to the U.S. market made topical by the ominous protectionist winds stirring in that country. But if economists are listened to at all, the efficiency issue remains important, because our negotiators may be encouraged to make major concessions in order to secure access, in the belief that such concessions will easily be "paid for" in higher productivity.

What will we in fact have to give up to achieve security of access to our U.S. markets? Here the banal but powerful cliche of the "level playing field" looms into view. Many of the "rules of the game" disputes seem to concern fundamental issues of the type of economy we are to work in, and the income distribution that it should deliver. Americans complain about our stabilization schemes, income assurance and alleged subsidies, whereas Canadian manufacturers tell me that their biggest problem with free trade will be coping with the lower wage costs of their U.S. competitors.

Now, what is more likely to get levelled – the Canadian bumps or the U.S. mountains? Economists who assume that because of our size we are a "price-taker" with respect to the United States, should also assume that we are a "policy-taker". The U.S. is likely to have much more success getting us to dismantle our income distribution policies than we will have demanding that a higher proportion of the U.S. labour force be unionized, and that U.S. employers should pay regular wage rates to their illegal immigrant workers. The levelling-out process will make us much more like them than vice versa.

What do economists think about that? This is where the "hidden agenda" comes in. Amongst Canadian economists there has long been a sort of one-way "free trade" in ideas. A full 70 per cent of the members of the economics departments at Queen's, Western Ontario, and the University of British Columbia have Ph.D.s from U.S. universities. Another 12 per cent earned their degree from Queen's, Western or UBC (plus two people from Toronto) – that is, they were educated by U.S.-educated economists. Remarkably, not one of the more than 100 faculty members of these departments has a Ph.D. from any other Canadian school. I am suggesting that your average "well trained" Canadian economist was imbued, in the most impressionable period of his intellectual life with a peculiarly American way of looking at things, namely, the doctrine of "modern neoclassical economics".

Neoclassical economics takes Adam Smith's marvellous insight into the value of letting people get on with the job to absurd lengths, leading to what, in a related context, Richard Lipsey and Murray Smith have recently called a "laissez-faire mythology".[8] It is centred on the notion of a unique perfectly competitive equilibrium, and it is the inadequacy of that concept that is responsible for the doctrine's great Achilles' heel – its utter failure to come to terms with the greatest economic problem of the age, namely persistent mass unemployment.

Mass unemployment – which, incidently renders invalid most free trade theorems – has not gone completely unnoticed within the profession, and there are signs that some of the most creative economists in both Canada and the United States are beginning a search for new perspectives and new models which may yet develop into a much-needed intellectual renaissance for the subject. Models with imperfect information, models of "efficiency wages", experimental findings on consumer rationality, and the burgeoning interest in "strategic" factors in market behaviour are leading economics toward a view of the world in which multiple equilibria, none of them Pareto-optimal, are possible.

But this may come too late for the generation of economists trained to think of both tariffs and union wages as "distortions" from a perfectly competitive ideal. It is difficult to explain (without invoking ideology) the uncritical acceptance by many of numbers as high as 10 per cent of GNP as the payoff to dismantling the remaining tariff barriers between the U.S. and Canada. To put this in perspective, there have probably been only four or five economists in history – Smith, of course, Ricardo, Marx, Keynes and perhaps Milton Friedman – whose ideas have mattered that much to our economic fortunes (and in at least two of these cases the influence was probably negative). Will the New Keynes please stand up?

In fact, this may be the worst of times – for economics and for the economy – to try and negotiate free trade. Economists may change their minds about the benefits, and the United States is in no mood to hand over another Auto Pact. Perhaps it would be better to batten down the hatches, fight the Americans on each protectionist issue as it arises, and wait until the U.S. trade position swings back into surplus before trying to sign a comprehensive trade treaty. But if we do proceed, our negotiators should count on something other than massive productivity benefits to compensate for giving ground on cultural sovereignty, access to resources, and Canada's social and development programs.

Notes

1. See Volume 1 of the Commission's Report, p. 329. The figures refer to the gains from eliminating tariffs at their pre-Tokyo Round levels. The range of actual gains in the late 1980s is put at three to eight per cent, because some of the productivity improvements are supposed to have been already achieved by the Tokyo Round cuts. It is the higher range that is relevant to this paper, since our data are for the year 1982, before implementation of the Tokyo Round of the GATT.

2. Though surely not all – cf., for example, Watkins (1985), and Wilkinson (1985).

3. Tariff-inflated prices attract excessive numbers of firms into industries, so that, on average, production is in plants too small to exploit all economies of scale. See Muller (1982) for a survey and evaluation of the "Eastman-Stykolt Hypothesis".

4. I should note a "mea culpa": my (1981) study of the costs of protection obtained a quite large number for the gains of unilateral tariff reduction by assuming that low-cost firms could easily expand to take over the production of any high-cost firms forced out of business by loss of tariff protection (see also my 1984a article).

5. The database was put together by Robert Wall and the author.

6. To compare productivity levels we would need data on input prices to match the output prices shown here. Such data are currently being collected.

7. Including reduction in "rent-seeking" activities if policy-makers were stripped of tariff-setting powers.

8. See "Unfair Trade Practices are the Crucial Issue", *Globe and Mail*, February 7, 1987.

References

Baldwin, J.R. and P.K. Gorecki. *The Role of Scale in Canada-U.S. Productivity Differences*. (Ottawa: Royal Commission on the Economic Union, 1986).

Eastman, H.C. and S. Stykolt. *The Tariff and Competition in Canada*. (Toronto: Macmillan and Company, 1967).

Economic Council of Canada. *Changing Times*, 23 (1986).

Frank, J.G. *Assessing Trends in Canada's Competitive Position*. (Ottawa: The Conference Board of Canada, 1977).

Gupta, V.K. and M.A. Fuss. "Returns to Scale and Suboptimal Capacity in Canadian Manufacturing: A Cost Function Approach." Working Paper #7904, prepared for the Institute for Policy Analysis, University of Toronto, 1979.

Hamilton, Bob and John Whalley. "Geographically Discriminatory Trade Arrangements." *Review of Economics and Statistics*. (August 1985), pp. 446-455.

Harris, R. and David Cox. *Trade, Industrial Policy and Canadian Manufacturing*. (Toronto: Ontario Economic Council, 1984).

Harris, Richard G. "Summary of a Project on the General Equilibrium Evaluation of Canadian Trade Policy," in *Canada-United States Free Trade*, ed. by John Whalley (Toronto: University of Toronto Press, 1986).

Hazledine, Tim. "The Regional Implications of the Canadian Tariff Structure", *American Journal of Agricultural Economics*. (December 1978), pp. 1030-1035.

_________. *The Costs of Protecting Jobs in 100 Canadian Manufacturing Industries* (Technical Study 16). (Ottawa: Task Force on Labour Market Development, 1981).

_________. "Testing Two Models of Pricing and Tariff Protection with Canada/United States Data", *Journal of Industrial Economics*. (December 1980), pp. 145-154.

_________. "The Possibility of Price Umbrellas in Canadian Manufacturing Industries", *International Journal of Industrial Organization* 2. (September 1984), pp. 251-262.

_________. "The Harris-Cox Model and an Alternative", Department of Agricultural Economics Discussion Paper #8404, University of British Columbia, Vancouver, 1984.

Hill, Roderick and John Whalley. "Introduction", in *Canada-United States Free Trade*, ed. John Whalley (Toronto: University of Toronto Press, 1986).

Lipsey, Richard C. and Murray G. Smith. *Taking the Initiative: Canada's Trade Options in a Turbulent World.* (Toronto: C.D. Howe Institute, 1985).

Macdonald Commission. *Report of the Royal Commission on the Economic Union and Development Prospects for Canada.* (Ottawa: Supply and Services Canada, 1985), v. I.

Markusen, James R. "Canadian Gains from Trade in the Presence of Scale Economies and Imperfect Competition", in *Canada-United States Free Trade*, ed. John Whalley (Toronto: University of Toronto Press, 1986).

Muller, R. Andrew. "The Eastman-Stykolt Hypothesis Reconsidered", *Canadian Journal of Economics.* (November 1982), pp. 757-765.

Watkins, Mel. "Reservations Concerning a Free Trade Area", in *Canada-United States Free Trade*, ed. John Whalley (Toronto: University of Toronto Press, 1986).

Wigle, Randall. "General Equilibrium Evaluation of Canada-U.S. Trade Liberalization in a Global Context". Paper prepared for University of Western Ontario Centre for the Study of International Economic Relations, February, 1987.

Wilkinson, Bruce W. "Canada-U.S. Free Trade and Some Options", *Canadian Public Policy.* Supplement (October 1982), pp. 428-439.

_________. "Some Comments on Canada-U.S. Free Trade", in *Canada-United States Free Trade*, ed. John Whalley (Toronto: University of Toronto Press, 1986).

Wonnacott, R.J. *Canada's Trade Options* (Ottawa: Economic Council of Canada, 1975).

__________ and P. Wonnacott. *Free Trade Between the United States and Canada: The Potential Economic Effects.* (Cambridge: Harvard University Press, 1967).

Wonnacott, P. and R.J. Wonnacott. "Free Trade Between the United States and Canada: Fifteen Years Later", *Canadian Public Policy*. Supplement (October 1982), pp. 412-427.

Young, J.H. *Canadian Commercial Policy*. (Ottawa: Royal Commission on Canada's Economic Prospect, 1957).

IV

Special Issues: Technical, Political and Social Dimensions of Free Trade

Bankruptcy Law, Free Trade, and Economic Adjustments: Preliminary Considerations *

Benoît-M. Papillon

I. Background

According to Canadian Constitutional Law, matters connected with Bankruptcy and Insolvency are under the legislative authority of the Parliament of Canada. The present Bankruptcy Act was enacted in 1949 and amended in 1966. Since then there have been recurrent debates about a reform of this legislation in Canada but with no practical result. In the United States, within a shorter span of time, the whole law was first reformed with the Bankruptcy Reform Act of 1978. Following two decisions of the U.S. Supreme Court, further changes were required, and in 1984 the Bankruptcy Amendments and Federal Judgeship Act were adopted. And again last year, the U.S. Bankruptcy Code was further amended by the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986.

II. Bankruptcy and Economic Theory

Our interest in bankruptcy law is part of an investigation on firm adjustment to trade. We are therefore primarily concerned with the application of the bankruptcy law to businesses, and more specifically, to manufacturing firms. From an analytical point of view, the discussion of business bankruptcy calls for a closer look at the concept of firm, which is used again and again. It calls also for a closer look at the nature of economic opportunities. As economics as a science (or as part of scientific endeavour encompassing other disciplines) is moving on, a notion like firm is subject to revisions. Intuitively, one could conjecture that any argument about a reform of bankruptcy law, referring widely to firms, or at least their empirical proxies (corporations, partnerships) must somehow be connected with the subject matter of economics.

---

* This paper reports briefly on a research on Bankruptcy Law for the project Firm Adjustment to Trade of the Economic Council of Canada. Discussions with Paul K. Gorecki have been useful. Bradley Rolph has contributed to the production of new data in connection with this research.

The views and interpretations remain the responsibility of the author and, as such, have not been endorsed by members of the E.C.C.

A brief survey of standard elementary textbooks in economics would disclose words like "scarcity," "decision" and "resource allocation." Since laws and economic policies in general do not enter directly into the making of goods and services, resource allocations per se present a limited interest within discussions on legal reform and economic policies.[1] More and more, economic theory refers explicitly to resource allocation mechanisms; and applications are found in the study of economic organizations, laws, institutions. On the basis of this rejuvenated approach to the study of the economic problem, we will make conjectures on the role of the law, or maybe more essentially, of legal changes. That is the starting point of our analysis.

With reference to the context within which it should be conducted, it is important to observe, first of all, that bankruptcy proceedings constitute some kind of discontinuity in a few of the overall set of relations of exchange which make up the social component of our production system. Growing emphasis on adjustments in recent policy discussions, and especially trade related ones, indicates a deep concern for these discontinuities. J.R. Baldwin and P.K. Gorecki have juxtaposed a number of observations on discontinuity in plant ownership and job affiliation which give some kind of overall picture of what one might call the rate of resource reallocation for the Canadian economy.[2] It does not seem to be an exaggeration to talk about these discontinuities as being pervasive. In the context of these discontinuities we propose a number of considerations on the bankruptcy law.

III. Free Trade and the Adjustment Process

We have indicated previously that our interest in bankruptcy law is part of an investigation on firm adjustment to trade. The connection between bankruptcy law and adjustment to trade is not, however, obvious. The basic posture taken in our inquiry is to view the bankruptcy law or, maybe more appropriately, changes in the bankruptcy law (and possibly changes in some other laws) as part of a set of feasible actions on the matter of adjustments. Other attempts at taking a broader view have been made by some authors on the topic of subsidies to firms and bailout policies.[3] It may appear to be a way to avoid the main question, but it may as well be one step back in order to dive deeper into the whole matter of adjustments and freer trade. Can we, in general terms, think about some factors which stand in the way of an achievement of freer trade?

New opportunities for our business and stiffer competition are recurrent themes in the discussion of freer trade with the United States and other countries. There is not a consensus on the effects of freer trade, but the frequent use of the terms "adjustment" or "adaptation" uncovers a general feeling about significant changes to take place (reduction of the demand for a product, excess capacity in the industry, location of new investment, . . .). There is a continual flow of changes which are handled by our economic system. Resource reallocation referred to above is a response to these changes. The possibility of an added set of changes from foreign sources, or let's say trade-related, poses the question of the quality of the performance of our system in comparison to foreign ones, especially the U.S. If we enter into a closer economic relationship with the United States what is going to happen to production in Canada? Is it still going to be valuable (along with the big portion of our wealth which is tied to it)? Comparisons between Canada and the United States of past records on productivity can provide a number of indications about the possible outcomes we should expect.

Given the set of institutions (trade barriers are some of them) we have inherited from the past, trade liberalization is a collective decision, and if a strong case about adverse effects can be made, other collective decisions will likely be in order as well. We can describe or summarize adverse effects by referring to firms in financial difficulties, due to foreign competition.[4] A whole set of precedents in economic policy on the matter of state relation with failing firms are with us; and some of them are about very direct involvement of the state as the transfer of tax receipts to businesses on the verge of bankruptcy. It is unrealistic to think that we can do away with these precedents in the context of freer trade by simply pointing out that we are facing a new set of changes unencountered before. However, our ability to do away with these precedents is crucial; any progress towards freer trade is barred by the use of non-tariff barriers (NTB). The transfer of public funds to some firms about to be weeded out of the market is an especially baffling kind of NTB.

The basic justification of an agreement allowing freer trade is the achievement of superior performance by participating economic systems. It is difficult to reconcile this justification with the subsidization by the state of a less productive firm in order to support competition with foreign firms. This very obvious preferential treatment creates a strong pressure towards defensive moves of a similar kind by the foreign state. Indeed, subsidization of a firm in the above context can be seen as an extreme form of predatory pricing.[5]

Therefore, progress towards the achievement of freer trade is conditional upon the adoption by governments of a number of rules of conduct in their relation with the production system.[6] More and more the achievement of freer trade (or maybe the maintenance of trade at its current level) appears to be conditional upon the agreement on a new set of rules of conduct among ourselves on our respective sides of the border. This is why intensive trade negotiations with an important commercial partner as the United States is for Canada generate very basic questions about the state and the economy, or more specifically, about the adjustment process (or mechanism of resource allocation). So much for speculations and conjectures on progress in trade negotiations.

IV. Changes Calling for Adjustment

Being a little more explicit about the flow of changes referred to above, there is in modern economies such as Canada's a continuous flow of technical innovations and a population with needs and tastes changing in the overall. Between these events and the values estimated for an overall measure of economic performance like productivity, there is the issue of how these events are handled. Laws, or maybe more appropriately, legal changes and government policies, in combination with production decisions within firms, could be viewed as composing the adjustment process of the economy.

We can use the removal of barriers to access to foreign production as an illustration of a source of changes calling for adjustment. It seems to be a conjecture shared among many that the transition to freer trade will expose Canada's businesses to more numerous fluctuations in their usual markets and will call for the risky search of a clientele even more tailored to their production potential. Beyond a category of things (buildings, machines, desks, . . .) which can be located at a single point or dispersed among a number of geographical sites, what we mean intuitively when talking about a business or a firm is an association required by modern technology at large.[7] People sell their time and other resources through these associations. Changes we are usually concerned with are those which will put former contracts, explicit as well as implicit, under which people enter into an association, and former ways of contracting, under a greater stress. For instance, as a result of these changes, will plants which used to provide lifetime employment operate with a reduced number of employees or even close down? Will there be a discontinuity of association? The answer we get to this kind of question depends upon the adjustment process (in the broad sense indicated above) which has been institutionalized over the years in Canada.

Observations on discontinuities in plant ownership and job affiliation reported by J.R. Baldwin and P.K. Gorecki do not embody any kind of measure of performance.[8] Rather, they try to take a more direct look to the adjustment process at work in the Canadian economy. The interpretation of discontinuities in production relations through a better understanding of the nature of our adjustment process is not of little importance. Over the years the Canadian parliament has voted growing amounts of "adjustment" public funds: unemployment benefits and programs of various kinds (bailouts, loans, labour training, . . .). The data upon which this allocation of public funds is made by the state consists of or are derived from the survival records of businesses. The policy of transferring directly public funds to production units or to people on the basis of past or future membership in such units is one category of state actions which compose, along with other uses of state powers, such as changes to the Bankruptcy Law, what we have called the adjustment process in Canada.

In moving away from overall measures of performance and in looking more directly at the adjustment process, we are abandoning norms or criteria on the basis of which we could make judgments. Since laws or changes in laws and government policies do not, as pointed out above, enter directly in the production of goods or services, neither can engineering nor managerial considerations be the only source of inspiration. On what basis then can we judge the quality of an adjustment process and of its various components?

Broadly speaking, one could say that the main economic problem is to make sure that "no significant benefits from exchange among economic agents are left unexploited;"[9] particularly, that everybody who is willing to work is getting a job. In other words, it is to make sure that resources are not misemployed – unemployment being one extreme form of misemployment. Why is this function not trivial? Borrowing from F. von Hayek, it is essential to recall that the knowledge about the resources available and about the needs is totally dispersed in the population, and there is very little basis on which one could stand up and tell to everybody else what they will do and what they will get. All that we can hope for is to suggest the best possible coordination between people's actions, or between resources made available through them, and their needs.

One could argue that in a stable environment the required knowledge to handle the coordination problem through commands would become available. What makes the availability of knowledge and coordination sensible matters of concern is the continuous flow of changes, which make knowledge even more temporary in nature. And it is on its ability to handle these changes that an adjustment process needs to be judged; what is coming out of the adjustment process is a sequence of resource allocations. Because of "knowledge" considerations, we cannot judge easily the quality of this sequence of resource allocations at matching the production potential with people's needs. And it might not be totally satisfactory to focus only on, let's say, the material artifacts of an economy. Therefore, as a complementary task, we may try to judge the quality of the adjustment process or resource allocation mechanism in handling the main economic problem.[10] This brings us back to what we have announced earlier as being the starting point of our analysis.

So far, we have emphasized the distinction between resource allocations and the adjustment process (government policies, laws, and production decisions) which determine these allocations.[11] On the basis of this distinction we look for a connection between small considerations on the bankruptcy law and the whole matter of economic changes. But is it not a little too abstract and maybe irrelevant?

Our concern for changes and the way we translate this concern into state actions are related to the lenses we use in gathering facts and reporting on reality. One of these lenses, and an important one, is the Standard Industrial Classification (SIC) System. Almost any economic fact, other than financial or monetary-related, is collected and reported through the use of this system. If carried too far, the standardization of products or commodities embodied in the SIC system may tend to bias the discussion of an issue like free trade towards a simplified view at substitution, and towards a compensatory approach in our ways to handle changes which can be quite arbitrary.[12] Goods are valuable in their final uses and this is not something which can be observed directly for a large population.

Another way to put our research on bankruptcy law in perspective, in the context of adjustment to changes and the discussion of trade-related policies, is to say that it is an illustration of how one could move away from the compensatory approach. Changes are pervasive and forgetting it in the interpretation of measures of discontinuities in production relations can lead to state actions in compensating those whose source of income is disrupted, which can be quite arbitrary. Indeed, direct actions by the state on a large scale can become a significant determinant of these discontinuities. The question, then, is whether these state actions bias in the wrong direction decisions through which the production system is operated and modernized. On the other hand, one might reasonably argue that a lot of discontinuities reflect a high level of experimentation in the matching of resources. And this experimentation is the most important input in the production of knowledge which insures that resources are well employed.

V. Is a Change in Bankruptcy Law Necessary?

For the simple reason there is already a bankruptcy law in place, some knowledge of how this one works is a prerequisite to any discussion about reform. In the first area of our research on bankruptcy we have gathered facts which could serve this purpose. Using published sources, we have put together a number of observations on the use of the bankruptcy law in the recent past. We observe a sharp increase from the 1970s to the 1980s in the number of bankruptcies for "Manufacturing Industries" as well as for "All Sectors." One can think about many comparisons between the occurrence of bankruptcy and variables connected with other aspects of business activity and organization of production in the economy.

With the use of statistics like GNP on a quarterly basis, cycles in the level of economic activity have been located and measured over the time scale. Business cycle analysts have integrated observations on bankruptcies to their work and observed, using U.S. data, that fluctuations in bankruptcy are a "lengthy leading business cycle indicator."[13]

Obviously, for a business to go bankrupt it needs first to be in existence. Therefore, among the factors which could be mentioned in the interpretation of variations in time series on bankruptcy are those connected, for instance, with the rate of new business formation. Various sources report an acceleration of the rate of business formation in the second half of the 1970s. Given that the number of business bankruptcies remain a small figure in comparison to the whole business population, an increase of a few percentage points in this rate can be a significant factor. If we take for instance the year 1981-82, which is the one showing the biggest jump in the number of bankruptcies, with an increase of 2,710 bankruptcies, this increase is about four per cent of the number of business corporations formed in 1979. And if we compare this increase with the increase in the number of business corporations in two or three prior years, it is under 30 per cent. More precisely, with increases in the number of newly-formed business corporations from 1977 to 1978 and from 1978 to 1979 of respectively 10,204 and 9,089, the 1981-82 increase of 2,710 in the number of bankruptcies is respectively 26.6 per cent and 29.8 per cent of these increases. Assuming a few years' delay makes sense, we can see justifications at connecting the huge increase of the early 1980s in the number of bankruptcies with policies and conditions in the late 1970s.

Businesses declaring legal bankruptcies are relatively small. On the basis of the amount of estate liabilities reported in some of the documents initiating legal proceedings (Manufacturing Sector, 1979-1985) and compiled by civil servants, we have observed that in more than half of the cases, the amount is smaller than $100,000.[14] In less than 10 per cent of cases, the amount reported is over $1,000,000. This is for businesses filing, voluntary or involuntary, for bankruptcy. There is another type of proceedings available under the bankruptcy law, that is, making a "proposal." Businesses going through this kind of proceeding under the bankruptcy law tend to be a little bigger. For instance, the amount of estate liabilities reported is smaller than $100,000 in about 30 per cent of cases and above $1,000,000 in nearly 30 per cent of cases. But proposal proceedings are not frequently used; indeed this is an important characteristic of our bankruptcy law, in comparison to, let's say, that of the U.S. Again for the manufacturing sector over the period 1979-1985, there were only 203 proposal cases for 4,519 bankruptcy cases. However, if we look at the small number of cases with claims in the amount of a few million or more, the ratio of the number of proposals to the number of bankruptcies can get as high as one to two.

In order to go beyond considerations on size only, and to take a more complete look at the use of the bankruptcy law by businesses in the manufacturing sector, we have surveyed the content of files in local offices of the Superintendent of Bankruptcy for 188 manufacturing firms (1979-1985), including all proposal cases with closed files (regardless of the size) and all bankruptcy cases with closed files, where the reported estate liabilities were over $1,000,000. Preliminary results support some observations already reported in the literature, such as the very small dividend, if any, distributed to unsecured creditors; while other results produce (to our knowledge) new facts, such as the relative importance of suppliers as creditors.

The first area (mainly descriptive) of our research is being completed by taking a more direct look at the law. We briefly survey what appears to be the main features of the Bankruptcy Act. The notion of insolvency is closely related to the legal concept of bankruptcy, but the Bankruptcy Act is not the only law which raises the issue of firm insolvency within the legal system. Many other laws and legal institutions are connected with firm insolvency. This leads us to ask the question why, given some desired improvement in the adjustment process looked for through legal changes, should we act on the bankruptcy law rather than on other laws?

Laws and policies are not put in place or changed through the consent of distant gods but of people, and of those in whom they are willing to recognize authority in these matters. Any discussion of possible changes in the bankruptcy law needs to start from their views and the way they express them (stated objectives of the Bankruptcy Law and arguments for reform). Given the numerous references which we find in Canadian newspapers and reports to the bankruptcy law in United States, the U.S. law is also relevant in the current context. More specifically, reorganization under U.S. bankruptcy law proceedings receives a lot of attention. Against the impression one might get by the attention devoted to the now famous Chapter 11 (on reorganizations) of the U.S. Bankruptcy Code enacted following the 1978 reform, a straight legal approach to reorganization is not a recent phenomenon in the United States. We might ask if it is not part of a legal tradition of the same as the one which has produced at some point a regulation of railroad reorganizations and farm reorganizations. This is quite a sensible conjecture in light of the 1986 amendment which has re-enacted a new Chapter 12 (corresponding to old XII) on farm reorganizations.

A survey of discussions on current reform proposals in Canada indicates that arguments are frequently cast in terms of "redistributive" considerations among various categories of creditors, or to the advantage of one specific category (especially the wage-earner). These arguments assume distinctions in the status of creditors which could be, in some sense, quite superficial if not spurious. For instance, why propose a reform which gives further advantages and protection to wage-earners, while the suppliers, a category composed in significant portion by self-employed people, appear to be heavy losers?

VI. Criteria for Change

In order to decide upon a reform of the Bankruptcy Law, and what the reform should do, we need some kind of criteria. The improvement of the adjustment process seems to be a much too broad objective for providing sufficient guidance and justification for some changes to the Bankruptcy Law in the small detail. Various elements connected with the phenomenon of bankruptcy have been discussed in the literature. One can encounter, for instance, some attempts at constructing models predicting the occurrence of bankruptcy. As referred to above, there have also been attempts at connecting fluctuations in the number of bankruptcies with variations in the level of economic activity. Among more theoretically inclined writings, one can trace a long debate (going back to Modigliani-Miller Theorem) on the existence of an optimal capital structure; some demonstrations rely partly on the possibility of bankruptcy. To the extent that the first two types of exercise are empirical ones starting with observations on the actual number of firms going through legal proceedings under bankruptcy law, it could not be more relevant to recall that they will explain "the real world only to the boundary line of law."[15].

In the literature on optimal capital structure, the term bankruptcy is not used in a legal sense but as synonymous of defaulting on a loan (or of insolvency). We do observe the practice of lending money on fixed terms to production ventures of a wide variety. And it is a practice which has been with us for a very long time. This practice relies on a set of customs and of legal institutions which is, with a few exceptions, assumed away or taken for granted in the literature on optimal capital structure. Research is an "iterative" process, and in this first round we have not found any criteria for legal reform.

Because bankruptcy law is closely connected with debt, (trivially speaking, without debt there would not be bankruptcy) we need to develop some intuition abut the practice of lending money on fixed terms to firms or production ventures. This is a prerequisite to the discussion of another set of theoretically inclined writings, which lawyers and economists have contributed to, on the use of security and priorities among claims. It naturally leads to a discussion of the nature of the economic opportunities that firms are constituted to exploit and to a discussion of the nature of the firm. Such considerations should set the stage for references to the discontinuities in the relations of exchange which make up the social component of our production system. These discontinuities give evidence of continuous adjustments to pervasive changes in the economy. As observed above, bankruptcy proceedings constitute one specific kind of discontinuity, and the analysis of the bankruptcy law has to be conducted with discontinuities in mind.

While the law and its application enjoy some level of autonomy with respect to governments, new laws are put in place through the governments. One can think about the state and the government as combining a number of functions or roles, which are not as easily separated as economists might wish between redistributive and allocative types. Broadly speaking, one could say that governments are formed to help us enjoy the benefits of living next to each other. An economic corollary of this broad principle would have to do with coordination or communication problems in a large economy and the institutionalization of an adjustment process to handle them. As guidance to governments, should we look for, in the specific domain of business laws, a normative (welfare) theory *of* the laws *or of* legal changes? Some essential aspects of bankruptcy law (a business law among others), for instance the order of priority of claims, seem to be quite arbitrary. Somewhat freed by the not very affirmative answers we have got so far in the literature, it might be in order to push the exploration in new directions.

Notes

1. This is the introductory statement of a research note on centralization where we look for a "framework within which it might be possible to identify the properties of various institutions, controls or policies a state can choose from", B.M. Papillon, 1986, p. 4.

2. J.R. Baldwin and P.K. Gorecki, 1986.

3. M. Trebilcock *et al.*, 1985.

4. To establish a causal relationship between firms in financial difficulties and foreign competition remains a complex empirical as well as conceptual issue. Empirically, one needs to look at the indirect (due to substitution) as well as to the direct effects of foreign competition on Canadian firms. Conceptually, firms in financial difficulties is a vague object. Unless we want to tie our welfare criterion with a variable such as "jobs lost", it needs to be refined.

5. Caricaturing to some extent, one could argue there is no economic agent with a deeper pocket than the state since the state's pocket is everyone's pocket. Empirical support has been provided recently in the literature for the hypothesis that a determinant of the decision by a state to distribute grants to businesses is the recent decision to do so in neighbouring states (W. Warren McHone, 1987; the study is wholly American, with states used as units of observation.)

6. We need to recognize this constraint in seeking better performance of our economic system through freer trade. The way we look at our past records of an overall measure of performance like productivity can be critical at this point. Our economic system can show up as a laggard through this measure. Many interpretations of that can be possible. Some with their implications support some form of infant industry argument in state policy and/or will trigger this kind of argument in the political arena whenever a new flashy technology pops up.

7. Scale in marketing, production.

8. With respect to the current body of empirical economic work on the economy at large, this makes their work somewhat marginal.

9. B.M. Papillon, 1986, p. 1.

10. It is at this level of considerations that one has to place "the pervasive and enduring interest in decentralized modes of mechanism" (S. Reiter, 1986, p. 1).

11. Although not exactly the same, a somewhat similar distinction has been made in the literature. For instance, in the literature on trade Blackhurst, R. *et al.* (1978) distinguish measures which "affect the efficiency of the allocative mechanism itself" from measures "which merely affect the allocation of resources." And by allocative mechanism, we must understand that they have in mind "the nature of the economic order expressed in the basic principles and laws by which economic principles are structured" (*op. cit.*, p. 72).

12. A new model of imported "boot" may offer or make possible a whole range of new activities which have very little to do with the standard uses of boots and shoes. The purchase of this new model, assuming we allow its importation, may bring, for instance, a substitution away from other sporting goods (maybe imported) because the new model makes hiking on otherwise slippery surface especially enjoyable and complements (better than anything else available so far) the use of sledges (a domestic product). Compensating or offering protection to domestic producers of boots and shoes in order to allow this new model in the country and because this new model, following SIC, is in boots and shoes, would therefore be quite inappropriate.

13. E.I. Altman, 1971.

14. Figures are from the Bankruptcy Master File made available by the Office of the Superintendent of Bankruptcy.

15. J.R.T. Hughes, 1976.

Selected References

Altman, E.I. *Corporate Bankruptcy in America*. (Lexington, Mass.: Heath Lexington Books, 1971)

Baldwin, J.R. and P.K. Gorecki *The Dynamics of Firms Turnover*, unpublished document, Economic Council of Canada, December 1986.

Bernstein, C. "Unions face a major threat in Chapter 11 – style proposals." *The Globe and Mail*, August 18, 1984.

Bisson, F. *A Perspective on Commercial Failures in Canada*, 3rd Annual Conference of the International Council for Small Business, Edmonton, April 1982.

Blackhurst, R. *et al. Adjustment, Trade and Growth in Developed and Developing Countries*. (Geneva: GATT, 1978)

Colter, G.F. *et al. Proposed Bankruptcy Act Amendments Report of the Advisory Committee on Bankruptcy and Insolvency*, Second Editor, Advisory Committee on Bankruptcy and Insolvency. (Ottawa: Supply and Services, 1986)

Commission on the Bankruptcy Laws of the United States. *Report of the Commission* . . . (Washington: U.S. Congress, 1973)

Conn, D. "Comparative Economic Systems Theory: Progress and Prospects," *A.C.E.S. Bulletin* (Summer 1983), pp. 61-80.

Consumer and Corporate Affairs, *Annual Statistical Summary*, Office of the Superintendent of Bankruptcy, various years.

Dunn and Bradstreet. *The Canadian Business Failure Record, 1985*. Dunn and Bradstreet Canada, Ltd.

Hayek, F.A. "The Use of Knowledge in Society." *American Economic Review* (September 1945), pp. 519-528.

Hughes, J.R.T. *Social Control in the Colonial Economy*. (Charlottesville: University of Virginia Press, 1976)

Hurwicz, L. "The Design of Mechanisms for Resource Allocation," *American Economic Review*, 63:2 (May 1973), 1-30.

Kryzanowski, L. and J. Holland. "Bankruptcies and Commercial Arrangements in Canada: Some Empirical Evidence." *Cost and Management* (Sept.-Oct. 1982), pp. 4-11.

Lewis, F. *Policy Forum on Reform of the Bankruptcy Act*, Policy Forum Series 7, John Deutsch Institute for the Study of Economic Policy, Queen's University, Kingston, 1985.

McHone, W.W. "Factors in the Adoption of Industrial Development Incentives by States." *Applied Economics*, 19 (1987), pp. 17-29.

Meckling, W.H. "Financial Markets, Default and Bankruptcy: The Role of the State." *Law and Contemporary Problems* (Autumn 1977), pp. 13-38.

Papillon, B.M. *Research Note on the Notion of Centralization*, unpublished mimeo, Economic Council of Canada, April 1986.

Reiter, S. "Efficient Allocation," Discussion Paper No. 674, *The Center for Mathematical Studies in Economics and Management Science*, February 1986.

Reiter, S. "Information and Performance in the (New) Welfare Economics." *American Economic Review*, 67:1 (February 1977), 226-234.

Slotnick, L. "Plan to Import U.S.-style Bankruptcy Law Draws Labor's Ire." *The Globe and Mail*, June 3, 1986, p. A3.

Trebilcock, M. *et al. The Political Economy of Business Bailouts*. (Ottawa: Ontario Economic Council, 1985), Vol. I.

*Financial and Economic Dimensions of Free Trade**

E.P. Neufeld

Will the Canada/U.S. trade negotiations avoid the shoals that saw them founder in 1947 and 1911? On those occasions when the moment of truth approached, Canadian shied away and let the opportunity pass. That could still happen this year, but it is significant that the support in Canada for the negotiations has remained remarkably firm.

Why is this? I am not at all certain that I know. Clearly it was not because of any fundamentally new findings concerning the advantages for Canada in opening up trade with the United States. Over the last two decades almost all analytical studies, while differing in terms of the magnitude of the gains from freer trade, have found such benefits and have advocated negotiations for realizing them. Outstanding among these was a recent one by Professor Richard D. Lipsey, who is with us today.

Most recently, indeed just two weeks ago, we saw the publication of another such study – a very fine one. This was by Paul Wonnacott, published by the Institute for International Economics of Washington, entitled *The United States and Canada: The Quest for Free Trade*.

It may of course be that all the old truths about the gains from trade are more broadly appreciated today. They always were appreciated where I grew up, in Saskatchewan – but the forces of economic common sense seem now to have broken out of the west and penetrated the east.

---

* I am grateful to Mr. Jeremy Taylor and Mr. Allan Yarish of the Royal Bank Economics Department for assistance in the preparation of these comments.

Quote possibly, the risk that Canada might lose the existing advantages of relatively open trade was a more influential factor behind this than the appreciation of new gains. But I do believe that Canadian industry is also more confident today than in the past that it can meet the demands of international competition.

The importance of securing continued access to the U.S. market has suddenly become widely recognized as a result of the forces of protectionism in the United States and the implementation of protectionist measures. These protectionist predators have made an increasing number of Canadians realized that the *status quo* is no longer the relevant benchmark against which to judge the benefits of an agreement with the U.S. This is because maintenance of the *status quo* is not an option we have. U.S. protectionist forces have unwittingly become an ally of the forces of freer trade in Canada.

It also appears that the strategic interests of the U.S. and the political interests of the U.S. administration would be served by an agreement with Canada. Progress in the areas of trade in services, copyright, and investment issues would clearly serve the U.S. well in the GATT negotiations; while a decent foreign trade "victory" would be welcome politically.

In considering benefits of an agreement to Canadians, the discussion so far has focussed much more on gains to producers through increased sales than *direct* benefits to consumers arising from lower prices. Yet these latter benefits are enormous. A recent federal trade commission study estimated that trade restrictions cost U.S. consumers about $50 billion a year, with huge gaps between the cost per job saved in protected industries and the wages actually earned in those jobs. This finding reminds me of calculations done by a student at the University of Saskatchewan over 30 years ago, which at the time appeared in a Saskatoon *Star Phoenix* editorial. It showed that Canada could fully support displaced workers in a certain protected industry out of the income gains to consumers through lower prices, and still be far ahead of the game.

Unquestionably the production effects of a move toward freer trade are more controversial. This is because, among producers, in contrast to the direct benefits to consumers, there are both "winners" and "losers". Furthermore the "winners" tend to be quite dispersed and the "losers" in some cases, more concentrated, more visible, and more vocal.

Let me just say a word about the impact across industries. Industries in which Canada is quite competitive (ie., in which our comparative advantage lies) tend to be the resource-intensive industries, based on the extraction and processing of our resource endowment. In a Canada-U.S. context, these industries would likely benefit most, particularly since the tariffs that remain generally escalate with the degree of processing. Ores and concentrates, for instance, face zero or minimal tariffs, while the refined primary metals face generally low (although highly varying) tariffs and the more highly processed fabricated metals higher still. The situation is similar in forest products, fisheries and other primary industries. Removing these tariffs would promote further processing of resource products prior to export, thus expanding those segments of the manufacturing sector. Again, too, the threat posed to many of these industries by the current protectionist sentiment in the U.S. is by itself a sound reason for pursuing an agreement.

Other parts of Canadian manufacturing—those less obviously based on an endowed domestic resource, like textiles, clothing and footwear, parts of the food and beverage industry, parts of the electrical and electronic products industry—may fare less strongly, based on comparisons of unit labour costs, technological superiority, and other factors. In many cases, the more vulnerable industries exist in Canada as a legacy of Sir John A. Macdonald's 1879 National Policy, which boosted tariffs as a means of encouraging domestic industrial development. It ultimately produced a fragmented industrial structure because foreign (especially U.S.) firms set up operations in Canada as an alternative to serving the market by exporting.

Therefore Canada now stands to benefit from the restructuring and rationalization of industries that a freer trade agreement would promote. Rather than having factories each produce a range of products for the domestic market, greater specialization would be encouraged by having them produce for the entire North American (or even the global) market. The longer production runs would stimulate greater cost efficiencies. Canada would also become a much more attractive base for foreign investors who want to get into the North American market.

Furthermore, the greater openness to international competition would encourage the more rapid diffusion and adoption of new technology, of new management practices and of new means of organizing production—what economists have labelled the dynamic gains from trade.

I do not believe that freer trade would lead whole industries to disappear; rather, firms would reorganize—and resources would be reallocated between firms in an industry—to produce larger, stronger entities, each with fewer product lines and each more capable of competing in the U.S. and other foreign markets. There would, of course, be some dislocations in the short run. Therefore, phasing in provisions and some kind of transitional adjustment policies on the part of government would be needed. The burden of adjusting to such an altered environment should be broadly shared, as was explicitly recognized by the Macdonald Commission.

Regarding adjustment problems, studies have found that industry adjustment to multilateral trade liberalization in the past has primarily taken place within rather than between industries. A reduction in the number of firms in an industry has tended to occur more through a lower birth rate of new firms, which is less disruptive than a higher death rate of existing firms.

Furthermore, it is apparent that the transitional costs involved in moving toward freer trade are not fundamentally different from the restructuring costs that a rapidly changing economy like ours faces all the time. I am thinking of changes in our resource industries due to shifts in demand or international competitiveness; in our manufacturing industries because of changing production technology; in our recreation industries because of changes in life styles; in our service industries because of the need to minimize labour costs; and in many hundreds of individual companies because of the failures of management, the need for rationalization or any number of other factors.

The textile and clothing industries are often singled out as being vulnerable in trade liberalization. This is especially true multilaterally (ie., as a result of successive GATT Round reductions), despite the restrictive effects of the (GATT-sanctioned) multifibre arrangement. But bilateral (Canada-U.S.) trade liberalization also raises certain issues for the sector as a whole. What we would expect to see, though, is a continuation, and probably an acceleration, of the process of adjustment to increasingly severe international competition.

The clothing industry, although hard pressed in the lower price/high volume segments of the market, has exhibited some success at moving into particular niches where export as well as home market profitability has been achieved. Examples of such niches include certain high fashion womenswear and institutional clothing.

Textile producers, in common with many clothing producers, have invested heavily in new technology, assisted by government grants. Unlike clothing, import penetration in the Canadian textile market has come mostly from the U.S., but Canadian firms are expected to compete under a freer trade agreement by specializing to a greater degree and by expanding (tariff-free) into the U.S. market more than they have.

So, in my view, both the primary and the manufacturing sectors would experience net benefits from a freer trade agreement, because of access to the vital U.S. market that is both less restrictive and, hopefully, more secure. But what of the tertiary, or service, sector that now dominates both the Canadian and U.S. economies in so many respects? Let me turn to that issue now.

As you are aware, the current Canada-U.S. trade talks offer an opportunity for an agreement on trade in services that could become a model for an eventual multilateral GATT agreement on services trade. However, services trade raises a host of issues that are much less apparent in goods-producing industries and this can be expected to complicate both the negotiations and the final agreement. To begin with, service industries tend to be more sharply differentiated between countries by differing regulatory environments. Some service industries are run by publically owned monopolies in one country and are open to competition in another. Moreover, regulations often vary sharply within a country due to the influence of provincial or state legislation.

While goods producing industries usually focus on tariffs or quotas as the main barriers to trade, service industries face more subtle impediments. Exports of services often require a foreign direct investment presence. Discrimination against foreign investment thus becomes a barrier to trade in services. For similar reasons, immigration and labour laws can influence services trade. All of these issues have high political visibility but must nevertheless be dealt with in a free trade pact that includes service industries.

Finally, services can, to an increasing extent, be exported without a substantial foreign presence, thanks to improvements in telecommunications technology. This means that current and potential barriers to cross border flows of information also have to be considered in any agreement on services trade.

Financial services are an important example of the complexity of trade liberalization in services. Both Canada and the U.S. are major participants in financial services on a global scale and any agreement between our two countries could set a precedent for a multilateral agreement. In addition, there are significant differences between the treatment of foreign and domestic financial firms in both Canada and the U.S. consequently, there are barriers to financial services that require a foreign investment presence. For this reason, negotiations in the financial services area will likely focus on the regulatory and institutional environment for foreign firms operating in the host country.

However, this approach immediately runs into an "apples and oranges" problem. Canadian and U.S. financial businesses do not operate in similar environments. The business powers of financial institutions differ widely between the two countries. As a result, trade liberalization in financial services cannot easily follow principles that might be appropriate in other service industries. National treatment, reciprocity and reasonable market access may have all been proposed as principles to form the basis for the negotiations. Each idea has some merit as an ideal but each faces practical difficulties in implementation.

The principle of national treatment, for example, would imply that there be no regulatory distinction between foreign firms and domestic firms operating in the same market. This approach would be appropriate when the industries are very similar from one country to the next. In the case of banking, however, the industries operate in significantly different institutional environments in Canada and the U.S. Canadian laws allow banks to operate nationally and will shortly allow a mingling of banking, trust and securities activities. In the U.S., in contrast, banks are restricted to operating in specific states or regions and are not permitted to engage in most securities functions. National treatment would, thus, imply that Canada and the U.S. would be granting very different concessions to one another. It is not an acceptable option for coming to a deal on financial services.

Nor can one just simply opt for direct reciprocity, since in practice it is unworkable. If Canadian banks were to receive national banking powers in the U.S., for example, we would then have powers that are currently denied to U.S. domestic banks. Moreover, in the United States, banking is regulated by both national and state laws and it would be difficult, if not impossible, for the U.S. federal government to deliver on any commitment to interstate banks. Trying to grant Canadian banks reasonable market access in the U.S. would run into similar problems.

Having said that, it is still apparent that reciprocity and market access, in some general rather than precise sense, must have some influence in a trade liberalization agreement. But since no single principle can be used exclusively, we have to look at specific issues and strive for an equitable trade-off on a case-by-case basis. For that reason, we have been arguing for a pragmatic approach to the negotiations that deals with the major barriers to freer trade in financial services between Canada and the U.S. Let me now outline some of the major points upon which we believe our Canadian negotiators must focus.

1. Business Powers

Legislative initiatives already contemplated by the federal and Ontario governments and governments of other provinces would, if implemented, unilaterally grant important new business powers to foreign banks and securities dealers. At the same time Canadian banks in the U.S. continue to be restricted by the Glass-Steagall Act and the Bank Holdings Company Act. Under the former any

Canadian dealer owned by a Canadian bank would be prohibited from operating in the U.S.

Let me emphasize that it would be intolerable for Canada to find itself in a position where U.S. banks and other financial institutions were given freedom to move freely into the Canadian securities business, while Canadian banks were left out of such businesses in the U.S. Sooner than letting that happen, the Canadian federal authorities should place "reciprocity" conditions on foreign institutions operating in Canada. It would simply be unacceptable for Canadian negotiations to forsake "reciprocity" in financial services for the sake of gains in other sectors. Accommodation of Canadian institutions through a U.S. policy change regarding Glass-Steagall should be a prerequisite for a further opening up the Canadian financial system to U.S. financial institutions.

2. Interstate Restrictions on Canadian Banks

Current arrangements give U.S. banks in Canada access to the entire Canadian market while Canadian banks in return are offered access to one or, at best, a few states. Since most Canadian banks in the U.S. find a New York presence essential and since New York banks are usually excluded from interstate banking compacts, Canadian banks are effectively limited to one U.S. market. Clearly, it is unacceptable to allow U.S. banks unrestricted access to the Canadian market without offsetting concessions from the U.S.

Full interstate banking powers for domestic and foreign banks operating in the U.S. would resolve this issue but such a development is unlikely in the foreseeable future. While a number of states have passed interstate banking laws, most of these are aimed at establishing regional subcompacts. Regions such as New England and the southeastern states have done this in an express attempt to stop money centre banks from moving into their regions. Although regional banking was challenged legally, a recent Supreme Court ruling affirmed the constitutionality of regional interstate banking arrangements.

More troubling still for Canadian banks is the fact that many regional interstate banking agreements specifically exclude foreign banks. This is another obvious impediment whose removal should be sought in the negotiations.

3. Extraterritoriality

A further issue where we need some movement on the U.S. side is the tendency of the U.S. government and regulators to extend their laws extraterritorially. This is of major concern to Canadian banks and a satisfactory agreement on this issue is an essential prerequisite to a freer-trade agreement. The potential application of U.S. capital adequacy standards on worldwide operations, state unitary taxation laws and the need to protect the privacy of non-U.S. based bank records are specific examples of this problem.

4. Trans-Border Data Flows

A freer trade agreement in financial services will also have to take a position on trans-border data flows. There are currently no major restrictions on the cross-border flow of information and we are not suggesting that unnecessary impediments be imposed. However, an agreement on appropriate safeguards that protect the privacy of client information while allowing for prudential regulation is very desirable.

5. Immigration

Immigration laws restrict the ability of Canadian firms to transfer staff to the U.S., particularly in the transfer involves spouses who may be ineligible to work in the U.S. If we are to allow for the freer operation of foreign subsidiaries in both Canada and the U.S., immigration laws will have to be relaxed to allow for easier transfers of staff across borders. Both Canada and the U.S. will probably have to make changes in this area.

Other irritants to Canadian banks operating in the U.S. include restrictions on intracompany credit extension and difficulties in obtaining deposit insurance for foreign banks. If Canadian banks are to operate effectively in the U.S., these impediments will have to be removed.

So, where are we? Will the negotiations succeed? This question, understandably, is the focal point of much current discussion. I see little point in spending much time on it. Indeed in my judgment the negotiations have already been immensely helpful. They have provided a crucial counterweight to the forces of protectionism. They have identified the specific obstacles for achieving progress in a number of sectors. They have tested the opinion of the body politic and so have clarified what is, and is not politically, possible. Failure, as such, therefore, is not now, in my view, a possibility—only the degree of success is at issue.

It has taken considerable political courage at the federal level to embark on the negotiations and to stick with them. This process deserves continued support.

Canada-U.S. Free Trade and Canadian Culture

Donald Armstrong

We Canadians have been warned that we must never allow Canadian culture to be put on that table around which Canadian-United States trade negotiations are taking place. Indeed, according to some, we must not even go to the bargaining table because free trade would undermine or destroy Canadian culture. With free trade, not only will we be hewers of wood and drawers of water, but we will also be nothing but bit players in our own melodramas!

This is strong stuff. But is it stuff of substance or stuff and nonsense? It is certainly the stuff of which questions (if not dreams) are made.

What is Canadian culture? Is there one Canadian culture or were there, at last count, 25,675,212 cultures, each one of which is to some extent unique?

Our culture is obviously not a single thing that can be measured along a simple axis, as can the length of our foot. Culture must have many, many dimensions, and the calibrations of the axes on which they are scaled will be something to behold. But what are these dimensions? How many are there? How important is each one? And what are those calibrations that we hope to behold? Can measures of central tendency for each dimension be defined, along with measures of badness of fit? And will Canadian researchers be able to distinguish themselves from American researchers by going metric?

Posing just some of the questions is enough to indicate how difficult it is going to be to find answers. This will be particularly so if the real questions have less to do with culture than they have to do with views of nationalism, ethnicity, racism, thinly disguised anti-Americanism and political ideologies, and the not-so-thinly disguised self-interest of those in the so-called cultural industries who would like to avoid competition.[1]

So let us try to keep our minds on the questions, the agendas, the hidden agendas of those who would quarrel with us, and our own hidden agendas, which in my case is a weak anti-nationalist sentiment (I am fed up with war) and a strong pro-market, anti-regulation ideology, (based, of course, on many years of perceptive observations and sound reasoning). Let us, therefore, gird our loins[2] with our high tolerance for ambiguity and nonsense, and with our love for a bit of fun[3], and let us get on with the unhidden agenda of culture and free trade.

Let us, moreover, take the sensible academic approach to this problem and structure our analysis so that it will not only serve the greater interest of mankind but also serve our own interests by providing the basis for a research application that we can submit to the Canada Council.

The research territory that we are staking out for ourselves is not exactly virgin.[4] The "bad Europeans" did not want the Economic Community to go forward because it would undermine national cultures and, God forbid, undermine their determination to be waging war on each other at least 1 year out of every 10. Many Newfoundlanders believed very strongly that they should not join the Canadian confederation since this would cost them their national identity – mind you, some of their best friends were mainlanders. More recently, some Quebeckers felt that it was worth breaking up the Canadian common market – to the rather limited extent that it is a common market – in order to preserve the Quebec culture. In our grant submission we had better promise to draw heavily on the experience of Europe and the experience that Canada has already had.[5]

Early on in our grant submission we will have to address the issue of what is culture – what is it that we propose to study? As we all know, culture has two meanings. Often it is taken to mean "high" culture in the sense of the arts – ballet and the like. Sometimes the expressed concern about Canadian culture and free trade does, in fact, seem to concern the arts. Culture is also used in the anthropological sense to describe almost all aspects of our lives.

Dimensions of Culture

When we are figuring out how much money to ask for, we had better remember that culture, particularly in the anthropological sense, must be a multi- multi-dimensional thing. Culture, like Bostonian breeding, is everything. It is

> ballet, of course; it is
> values and commitment to values; it is
> law and manners; it is
> religion, metaphysics, myths and fairy tales; it is
> crime and punishment; it is
> walking in the country side; it is even
> baseball – where we encounter some of our finest
> choreography!

Those of us who worked for the Royal Commission on Bilingualism and Biculturalism and, later, for the Economic Council, in just that little corner of culture that might have something to do with managerial achievement, identified almost 100 variables – and we were trying our best to keep the analysis simple and to stay under budget!

Measurability

Our grant proposal had better take into account the fact that if there is to be any hope of converting the infidels, or having our research published[6], then the issue of measurability must be addressed.

Let us illustrate the problem with something indisputably cultural. Ballet *is* culture. But who has ballet culture? Those who start counting as soon as the black swan begins her, hopefully, 32 fouettes? And are extra marks to be gained if the audience can hear the counting eight rows away? Other readings on the ballet-culture scale would have to include grades for those who go and enjoy, those who go and do not enjoy, those who don't go and wouldn't enjoy it if they did, those who don't go but would enjoy it a) if they had the time, b) if they had the money, c) if they only knew that in Act 3 of Swan Lake, Odile[7] is supposed to execute 32 fouettes to complete her seduction[8] of the prince, or d) all of the above. Being able to agree on measures of central tendency and to do the measuring when and if such agreement has been achieved is likely to use up quite a bit of our grant money – and require a season's ticket to Les Grands Ballets Canadiens.

Population Characteristics

Our discussion of culture will not get very far until we recognize the link between all of those things called culture and all of those things that describe the multi-dimensional characteristics of population, and, in this context anyway, should *not* be considered as part of culture. Let me burden you with an anecdote that will illustrate what I mean.

Some of the research I did for the B&B Commission involved working extensively with a francophone colleague. We got along very well, and it seemed to me that we agreed on just about everything except on the desirability of separatism. He was prepared to break up the free-trade arrangement we have had between Quebec and the rest of Canada because he and I belonged to two different cultures. At first this proposition was so self-evident to my francophone friend that the matter was not worth discussing, but being a great believer in "multidimentionalism" (life is never so simple as it seems), I finally persuaded him that we should make a list of all the elements or dimensions in our two cultures so that we could make an item-by-item comparison. Of course we had to discuss many things, but to cut a very long story short, he related to me the French Canadian culture that he had acquired as he grew up in rural Quebec: the importance of the church, the special role of the Mother and life with her in the kitchen, the unthinkability of divorce, the extended family; in other words, he produced for me a precise description of my childhood in the low-income, bible belt in rural Alberta. Of course we all crowded into Mother's kitchen; in a family that had to economize on heat it was often the only warm room in the house. In the absence of social security and with uncertain incomes, of course it made sense to have an extended family relationship. With no job market for wives and mothers, it was socially unacceptable to the community that a woman should be turned out of doors.[9]

The point of the anecdote is that even if it proved to be possible to measure the average cultural differences between two populations, one would not know what to make of such differences unless one could determine their cause. There are experiences, values, and life styles that go with certain economic circumstances. Rural poverty will produce a certain culture (or at least explain part of a culture) whether the rural poverty is in Montana, Quebec or Alberta. If there is, or has been, more rural poverty in one province than another, then the "average" provincial cultures of the two might be somewhat different. It would seem very strange to me that anyone would note the difference in cultures induced by rural poverty and suggest that we inhibit trade between the two provinces in order to preserve such cultural differences.

I assume that we would want to make a similar allowance for age differences. I have observed that younger people in both countries play their blasted stereo blasters louder than do adults. Let us suppose that our penetrating research leads us to the conclusion that there is a difference in the average cultural decibel readings in the two countries but that this difference was attributable to the fact that there was a slightly higher proportion of young people in Canada. I trust that this cultural difference would not be considered important, and that the Americans would not use it as an excuse for closing the border to keep out our shakers and swingles.

What other non-cultural population characteristics should we take into account in our research so that we may make the appropriate adjustments in any international and interregional cultural differences we happen to encounter? The population characteristics that I think we would want to include, in addition to the rural-urban split, income and wealth, and age that have already been referred to, are religion, ethnicity, and the amount and kind of education. Let me point out to you the very serious consequences of arguing otherwise. Is anyone going to suggest that we should *not* trade with countries or regions that have a different mix of religion, ethnicity or education than we have ourselves?

What I am suggesting is that before we take steps to preserve the differences in culture between two countries or two regions, we want to know what caused the differences and indeed whether the differences can, or ought to be, preserved. Clearly, I am of the view that we should not worry about preserving cultural differences that are based on the different incidence of rural poverty, less education or a different mix of religions or any of the other things that I have mentioned above. We had best stick another million dollars into this grant request: we would not like to be associated with any study that turned out to be an indirect way of preserving or promoting racism, bigotry, or poverty.

National and Regional Analysis

We had also better include in our grant application a promise to make lots of regional as well as national comparisons. It is very likely that the rural-urban, high-low-income, protestant-catholic, etc. population splits will produce differences in the average culture of regions (depending of course on how those average cultures are defined). On *a priori* grounds I would expect that if one matched Ontario with a state in the union that reflected the population characteristics of Ontario, one would find a more homogeneous cultural profile – a greater similarity of culture – than one would find between, say, Ontario and Newfoundland. Someone opposed to free trade with the United States may feel uncomfortable[10] arguing that people in Ontario must not trade with the Yankees because of cultural differences if it proved to be the case that cultural differences were even greater between Ontario and the Maritimes than they were between Ontario and Ohio.

Environmental Dimensions of Culture

Our grant application is not likely to have much credibility if we do not recognize that climate and other environmental factors are also going to have some impact on national and regional cultural values. For example, there is a well-known theorem among academics that in countries that are so hot that the wearing of clothes falls off, so too does the rate of submission of articles to learned journals.[11]

The Population-Culture Matrix

The time has come to talk about getting some hard numbers into our research proposal. This I would promise to do by building two 1000x1000 matrices, one for Canada and one for the United States. In each we would have a random sample of 1,000 people, and on the other axis we would limit ourselves to 1,000 cultural dimensions. The population characteristics of the people would, of course, be noted so that the comparison of sub-groups or sub-cultures can be made. What we will do then is to hire a large number of graduate students to fill in the one million boxes in each of our matrices.[12]

In our application we had best stress the usefulness of the data rather than the usefulness of the results: "lots of material for future generations of scholars who will be just itching to get their hands on this material," "lots of thesis material" – that sort of thing.

As for results, our research is going to tell us what we have known all along, which is that there is no such thing as a Canadian or an American culture. What we are going to produce for all of our efforts is, for a total of two thousand people, a partial description of two thousand cultures, each one of which is to some extent unique. There will not be any such thing as an Albertan culture or an Ohio culture either.

That does not mean, of course, that there will not be similarities among our two thousand different cultures. If we identify first-generation Ukranians who are engineering graduates of the catholic faith living in Winnipeg, we are likely to find some similarity in the way they respond to our cultural questions about preferences for baseball, birth control, and hard work. Common sense also tells us – it tells me anyway – that we are likely to see more similarities between the means for this group and a similar group living in Minneapolis than between our Winnipeg group and a group of protestant, bachelor-of-education graduates of British parentage teaching school in Toronto.

When my colleagues who worked on the B&B Commission compared like with like, francophone commerce students with anglophone commerce students, they found no important differences in those aspects of culture they were studying. And, by the way, when

I compared like with like, francophone civil engineers with anglophone civil engineers, I found no difference in managerial achievement either. Indeed I have already spent enough of the taxpayers' money to convince me that if it was our desire to break up Canada into culturally homogeneous units (presumably so that free trade could be further impeded), it would make more sense to put the commerce and engineering graduates in one country and put the arts and law-school graduates in the other, rather than to divide the country on ethnic or linguistic lines.

After we had "corrected" for the population characteristics noted above, would we find any residual dimensions of culture that would separate Canadians from Americans? I believe we would, but we would have to give quite a bit of weight to dimensions that are closely related to Canadian history and Canadian institutions. But I would predict that these national distinctions between Canadians and Americans would be less than the cultural differences that we would find within Canada and within the United States.

The Economics Approach

It is always a good idea when making an approach to an Ottawa granting agency to involve as many disciplines as possible.[13] It would behoove us, therefore, to put in a little something for the economists to do. Indeed the economists have something to say on this matter. Over the years those economists who support the market and free trade have developed a useful check-list of the advantages of free trade and of market solutions to the problems of the allocation of resources. On the other hand, those economists who have favoured regulatory, and command, solutions to the managing of the economy have provided an equal and opposite list of the advantages of government regulation.

So long as we are prepared to think of culture as a good or service that is capable of being supplied and demanded, embraced or rejected, and sometimes bought and sold, then it is possible and revealing to consider the regulation or deregulation of culture from the point of view of this venerable and on-going debate. From this starting point, one could then use as a check-list all of the pro-trade, pro-free-market arguments to urge the government to promote free trade in both ordinary goods and services as well as in all aspects of culture; or if one was so inclined one could use all the anti-trade, anti-free-market arguments to urge the government to protect us from both United States goods and United States culture.

Let us begin, and end, by going down the list of anti-free trade arguments as they might be used to defend the most cultural of the Canadian cultural industries – the ballet.

The Pauper Labour Argument

American ballet dancers work for only a bowlful of rice each day and if we have free trade, Canadian ballet dancers will have to accept the same low income.[14]

The Infant Industry Argument

Those wretched Americans got a head start, and we will have to protect our dancers for a while. Of course, in time our dancers will learn to stand on their own two feet[15] and *then* we can have free trade.

Defence

Without Canadian ballet dancers, how will we be able to entertain our troops when they are stationed in Moscow?[16]

Employment

Next Monday all able-bodied Canadians who are not now gainfully employed will be required to report to the corps de ballet nearest their homes.

By now it has been revealed that it is hard for me to take seriously the anti-free-traders, especially those who try to buttress their case with the rhetoric of cultural independence, cultural embargoes, censorship of foreign ideas and so on. But now I want to be serious.

First of all, two matters on research biases. It first struck me when I was working for the B&B Commission, and it has impressed me several times since, that there are very strong political, financial, and professional vested interests in proving that there are important differences among people. It is difficult to find a researcher whose self interest is served by proving that folks are folks – that Russians have many of the same interests as have Americans, or that Americans and Canadians are likely to laugh at the same jokes or cry in the same circumstances. Political leaders in particular are likely to gain importance and power by persuading their countrymen that they are all different than the aliens. And the greater these differences can be made to appear, and the more threatening they can be painted, the greater the power of politicians. Those young activists who are really anti-war should be working hard to minimize the importance of international, interregional, and even interprovincial boundaries. And they should be very suspicious of political nationalists and separatists who would have them march under the banner of nationalistic cultures.

Another research bias that I tried to discourage in the B&B days was what I considered to be the misuse of the tests of statistical significance. It was often a cause of rejoicing among the researchers when it turned out that one of their measures of this or that showed a statistically significant difference in the responses of anglophones and francophones. Being a simple man, I always withheld my applause until I saw the scatter diagram, the dispersion and the overlapping. A lot of the differences that got reported as "statistically significant" were, in my view, neither numerically significant nor, in any sense, important.

But enough of these details; let us get to the heart of the matter. Just suppose that there are cultural differences between Canadians and Americans, so what? Surely the whole point of the free society that I hope most of us would like to see for Canada is not whether Canadians have a homogeneous culture (how dull), or whether in some collective sense it is unique. The important matter is whether each of us Canadians has the right to choose from among those thousands of dimensions that, taken together, will define each of us as an individual. If among us there are similarities as there are bound to be – vive les similarités. If some of these similarities are both admirable and shared by many Canadians, so much the better. If there are differences (let us hope that there are), vive les différences.

Economic thinkers, in and out of the profession, have done an excellent job in demonstrating that human welfare and human freedom are optimized in the environment of a free market. And a "free market" is not the text-book model of perfect competition; it need mean nothing more than a market in which it is not a crime to compete. If free choice and the offering of alternatives among competing beans and beers can enhance human welfare, how much more important it must be to have that free market in the competition of ideas, and values and cultures. Closing the Canadian-American border against trade in goods and services would be simply mischievous. Trying to raise the barricades to keep out ideas, values, and cultures, would be downright sinful.

Notes

1. Let him or her who is without tenure cast the first stone.

2. That is OK to do now – we will apparently soon be seeing advertisements for loin girders on American television.

3. The alternative is to cry.

4. And let him or her who is do the first casting.

5. We can anticipate an interesting submission from the Assembly of First Nations.

6. Two things that are remarkably similar if you are out of the main stream of academic thought.

7. She is the black one.

8. Now is the time to quit if you have no stomach for this sort of thing. Culture can get pretty racy.

9. And let us be sensible about this; with so much production going on inside the home, who would do all that work as cheaply as would a Mother?

10. Research always involves some risks, and making the anti-free traders feel uncomfortable is just one of the risks we must be prepared to face.

11. Do not bother to send me your CVs; I am going to check this one out myself.

12. Lotus 4 5 6, your time has come!

13. Interdisciplinary projects are big right now; besides we can never be sure who will be sitting on the fund-awarding panel.

14. Or am I thinking of Japanese dancers?

15. Toes, actually, and preferably only one – a good point you will agree.

16. Or New York, should the NDP ever get into power.

CUFTA and Canadian Independence

Peyton V. Lyon

For virtually our entire history, most Canadians have agreed that free trade would be good for our economic well-being. Each time that we have come close to a comprehensive trade treaty, however, the fear has arisen that it would mean political suicide – for Canada or the governing party. The fear has been fanned by interests, and by opportunistic politicians. And each time the scare tactics have worked, greatly to Canada's detriment.

This time it may well be different. Only Shirley Carr and Mel Hurtig are waving the tattered flag once waved by Sir John A. Macdonald. (Isn't it nice that there still are a few genuine Tories in our midst?) Predictably the NDP is opposed, but not emotionally, its leader seems mostly to be concerned to conserve that great instalment of continental free trade – the Auto Pact.

The only serious discussion of sovereignty has not been about the sovereignty of Canada but rather the sovereignty of its constituent provinces. These are not necessarily the same thing! Indeed, no country on earth is as handicapped as Canada by provincial claims when it comes to negotiating major economic treaties. Narrow provincial interests, and an archaic constitution may well scupper the emerging trade treaty, or reduce it to an agreement hardly worth the ink needed to sign it. I choose to be optimistic; however, we must expect the Premiers to press the interests of their constituencies, but I don't think that Messrs. Peterson and Bourassa want to make their marks in history as the men who destroyed an initiative important to the whole of Canada, especially when opinion in Quebec and Ontario is divided and the smaller provinces are all in favour, with the possible exception of Manitoba.

I am delighted that the principal debate has focussed on the economic aspects, and I hope it stays that way. Let's leave it to the economists and exclude the gloomy political scientists!

But can we be confident that the debate will continue to focus on substantive issues, mostly economic, but also a few real political issues such as the probable necessity to harmonize some of our welfare policies? Can we be certain that John Turner, if his current comfortable position in the polls begins to slip, will not grab the mantle of Sir John A., thus completing the reversal of the historic positions of our two major parties? Will emotion, ill-founded emotion, again overtake cool reason, to the disadvantage of us all? It did not seem so during the debate on March 16. However, even if a 1911 style debate does not occur, many quite reasonable Canadians are likely to become apprehensive about our sovereignty as we enter the home stretch in the crucial negotiations. So I propose to review some of the considerations that should comfort those who have been disturbed by the likes of Carr and Hurtig. These thoughts were first published a dozen years ago in a study for the Economic Council. At the time I appeared to be the only political scientist in the country who favoured continental free trade. That situation seems little changed, but the arguments of my colleagues have become more knowledgeable, sophisticated and cautious, but still gloomy! We talk of economics as the "dismal science"! But the title really belongs to political science!

Few political scientists now adhere to the proposition that a free trade area is the first step on a slipping slope leading inescapably to a customs union, common market, economic union and finally political union. In the case of a disparate dyad, a two state system with high interaction and gross disparity, the process would amount to the absorption of the smaller into the larger. A classic statement was made by Mitchell Sharp in his celebrated Options article of 1972 that subsequently became government policy: "free trade areas tend towards a full customs union and economic union as a matter of internal logic. A Canada-U.S. free trade area would be almost certain to do likewise. If this were to happen," he continued, "Canada would be obliged to seek political union with its super power neighbour." Mr. Sharp is now less deterministic, but the line has been taken up by Premier Robert Bourassa—or should I say Professor? "If we start one degree of economic integration, it will be difficult to stop the others." "Free trade with the United States will lead to a customs union . . . which in turn will lead to common political institutions." Amazingly, M. Bourassa said that he learned this truth while he was a professor in Brussels engaged in the study of the Community!

Professor of what, I wonder? And what community could he have been studying?

It appears to have escaped Premier Bourassa's attention that the European Community started off as a Common Market – an advanced stage of integration – and it was the strong intention of its founders that it evolve into some form of political union. Its remarkable achievements are less the consequence of economic forces driving on reluctant participants, than they are due to fresh injections of political will whenever the integration process bogged down, as it often has done. FTA are devices employed by governments who want the economic gains of free trade without the necessity to pay a substantial political price. And they work!

To start economic integration may be a step onto a slippery slope, but it is far from clear which way the slope is sloping! Instead of FTA's always leading to Customs Unions, they have in fact never done so. FTA's characteristically remain at that level, or they disintegrate. EFTA is an example of an FTA that has achieved equilibrium with little harmonization of domestic politics.

The generalization holds true in the case of disparate dyads. For example, BNA-US, Norway-Sweden (both nineteenth century). Ireland-Britain, Luxemburg-Belgium, Austria-Germany, New Zealand-Australia are (all contemporary). (I'm told it didn't hold for Hawaii-U.S., and I'm applying for a SSHRC grant so that I can spend the next year in Hawaii to check out the claim).

If the slippery slope has lost some of its terror, many serious commentators still hold that Canada's foreign policy would be subjected to severe constraint if we entered a free trade arrangement. I believe quite the contrary. Indeed for me the gain in Canada's independence in the international arena would be the most attractive feature of a CUFTA.

Why? In the first place, we should be richer. Ten thousand economists can't be wrong! And there is nothing like money in the bank to enhance one's independence, the ability to formulate one's own goals and then achieve them. Canada, if wealthier, could afford a more active foreign policy. We might even afford an embassy in Finland! We could build a navy, and keep our commitments to international development.

Most important, a comprehensive trade treaty would relieve Ottawa of much of the current necessity to curry favour in Washington, in part by having to go along with its foreign policy even when we have doubts. When you rely heavily on trade, and sell over three-quarters of your exports in one market, you can't afford to offend the keepers of the gate to that market. I need not tell you that whole Canadian industries can be endangered by changes in U.S. regulations, quotas or tariffs – sometimes with intent to hurt, sometimes not. Ottawa decision makers, and our representatives in Washington, must always bear in mind that there are threatening bills in Congress, cases before regulatory agencies, and needs for Presidential support, perhaps his veto. The Embassy very often advises Ottawa to hold off on a particular initiative because it is desirable to keep the Administration sympathetic, and Congress at least tolerant, while a matter of interest is pending. Linkage of issues is traditionally taboo, but our leaders would be irresponsible if they ignored the impact on our economic interests that might be created by foreign policy positions that are resented in Washington. Retaliation is less the threat than deafness when we seek special consideration for our interests, or for our views on issues such as arms control or Nicaragua. I doubt if any treaty could be totally comprehensive, but who can doubt that Canadian independence in the external realm will be enhanced to the extent that access to its most vital market is guaranteed by treaty?

Canada, by the very act of concluding a FTA, might seem to others to be moving closer to the United States. But, as the Macdonald Report recommends, a more active foreign policy, one that stresses the roles we perform well and differently, would be the best corrective for any tendency to see Canada as a satellite. In any case, no one ever thought of Ireland as a British satellite during the decade of their free trade arrangement. And New Zealand, as it increases the tempo of its trade integration with Australia, has never seemed more boldly independent.

The most substantial political concern is the probable need to harmonize some fiscal and welfare policies. Already there is great pressure on nations who need trade to ensure that their domestic policies do not place their industries at a serious disadvantage, or that the subsidies of other states do not give their producers an unfair advantage. Studies of FTA's suggest that the degree of harmonization has proven less than anticipated, and acceptable. Nevertheless the studies are dated and in a disparate dyad such as Canada-U.S. it is reasonable to expect that the smaller country would need to do most of the adjusting. In the unlikely event that this proved to be very extensive, and called for a drastic change in our social philosophy, we should break off negotiations. But let's cross that bridge when we come to it.

If U.S. demands are not excessive, and it seemed likely that there would be significant economic gains, we should be foolish to retreat on the fallacious ground that we would be abandoning sovereignty and our independent foreign policy.

*Removing Barriers to Canada-United States Trade**

Frank Stone

Introduction

In March 1985 at a meeting in Quebec City Prime Minister Mulroney and President Reagan launched an initiative for a bilateral trade agreement between Canada and the United States the goal of which would be, among other things, to remove all or most remaining barriers to cross-border trade in goods and services, and to create an enlarged body of agreed rules to govern this trade. Negotiations have been under way since the spring of 1986. It appears to be the intention to draw up the new agreement by early next autumn, for consideration under the respective legislative processes in the two countries and, it may be hoped, formal approval by the end of the year.

The GATT rules, under Article XXIV, permit the two countries to enter into a free trade agreement, as many other GATT countries have done, provided that the agreement meets certain specified conditions. The primary condition is that the agreement should remove customs duties and other restrictions on substantially all bilateral trade, and that these should be removed within a reasonable length of time.

---

* This paper is a condensed version of a paper co-authored with Tom Burns, Public Affairs International, prepared for a conference on February 3, 1987, in Washington on "Building a Canadian-American Free Trade Area", which was held jointly by the Institute for Research on Public Policy and the Brookings Institution.

The purpose of this paper is to review briefly the variety of tariffs and other barriers to Canada-U.S. trade which should be removed, and the processes involved.

Previous Efforts to Remove Bilateral Trade Barriers

This will not be the first time that Canada and the United States will have removed, or attempted to remove, tariffs and other barriers to their cross-border trade. For a decade in the middle of the nineteenth century a so-called Reciprocity Treaty was in force which removed tariffs on most of their bilateral trade at that time. In 1935 a bilateral trade agreement was concluded between the two countries; this 1935 bilateral agreement, which was renegotiated and extended in 1938, substantially reduced many of the high import duties which blocked or impeded cross-border trade during the early 1930s.

These two bilateral agreements were suspended when the GATT came into force at the beginning of 1948. Since then, the GATT has provided a framework for the impressive reduction of the tariffs of both countries on cross-border trade as well as their trade with other GATT members. Equally important, GATT has provided a valuable set of rules which govern the use of tariff and non-tariff barriers to cross-border trade, as well as to world trade. And GATT has also provided a useful body of rules and procedures which have many times been used by the two countries to resolve bilateral disputes over trade policy.

But it has come to be recognized on both sides of the border that GATT has provided an incomplete and inadequate framework for managing the massive, intricate and unique bilateral trade relationship which is of such great importance to both Canada and the United States. Successive GATT negotiations have left in place a range of tariffs, a good number of which are relatively high, which still impede the flow of goods across the border and which reduce economic efficiency, productivity, competitiveness and growth in both countries. The rules of GATT and its supplementary Tokyo Round codes have proven to be inadequate to deal with the recurring trade problems which inevitably emerge between two countries whose economies are so closely linked – as experience in the past several years demonstrates all too well. And GATT does not provide the kind of institutional framework which is needed to manage the complex trade policy issues which are unique to the two countries. Moreover, the GATT does not cover cross-border trade in the services sectors, nor the flow of private investment, both of which are of such great bilateral importance.

The new round of multilateral trade negotiations under GATT which was launched in September 1986 will, of course, provide further opportunities for both Canada and the United States to reduce barriers to their cross-border trade as well as barriers to their trade with other important trading partners. But, however optimistic we may be about the new round of multilateral negotiations, they are not likely to lead to any comprehensive removal of barriers to cross-border Canada-U.S. trade, nor to the introduction of the kind of special rules needed to govern this trade; and these multilateral negotiations are not likely to be concluded for several years, because of their complexity and the number of countries involved.

It is a fact, of course, that the two countries have already gone beyond the GATT to put in place a number of purely bilateral arrangements to reduce barriers and deal with unique trade problems in several areas. Foremost among these are the Automotive Agreement of 1965; the special arrangements for bilateral trade in defence products; the historical removal by the two countries of their import duties on agricultural machinery; and the agreed arrangements covering Canada's use of seasonal duties on fresh fruits and vegetables. But it is remarkable that so few purely bilateral trade arrangements have so far been created between two neighbours whose economic ties and trade relations are so close, complex and important.

Gains from Removing Trade Barriers

The need for a new bilateral trade agreement, and the benefits which would flow from it for both countries, has been better recognized on both sides of the border in recent years—certainly in Canada. The mutual gains from the removal of barriers to trade across the common border would be large and permanent, stimulating investment, productivity, competitiveness, employment and growth in all regions of both countries. The impact on the Canadian gross national product would be greater in proportionate terms although not necessarily greater in absolute terms. At the same time, while new opportunities for enterprise will open in both countries, the problems of adjusting to the new free trade condition will undoubtedly be more difficult on the Canadian side and persist for a longer period.

To achieve the full benefits which both countries seek from the bilateral negotiations the new trade agreement will need to be comprehensive in its scope, and innovative in its design:

- tariffs and other barriers should be removed immediately or over a transitional period, with a minimum of exceptions; and for excepted areas, the agreement should set in motion processes aimed at opening the border over a period of time as completely as possible;

- the process of liberalizing cross-border trade should cover tariffs and other barriers in the agricultural as well as in the industrial and the services sectors;
- the agreement should build on, improve and enlarge the GATT rules as these apply to cross-border trade, to bring them into line with the unique and complex Canada-U.S. trade relationship; this process should include a fundamental revamping of the so-called "continent protection" or "trade remedy" systems of both countries as these apply to cross-border trade;
- in addition to the traditional areas covered in trade agreements, this bilateral arrangement should provide for effective rules or guidelines in the "new" areas which are emerging: trade in services, intellectual property rights, and trade related investment;
- the agreement should create new joint institutional arrangements, including rules and procedures for the resolution of disputes, to assist in the dismantling of barriers to trade, help avoid new barriers, and otherwise contribute to operation of the agreement.

Removal of Tariffs

Contrary perhaps to common perceptions in both countries, tariffs remain a significant barrier to cross-border trade in many sectors, and on both sides. Both countries have removed or reduced their tariffs in successive rounds of post-war GATT negotiations. The 20 per cent or higher tariffs on many textile and clothing products applied by both the United States and Canada are extreme examples, but many tariffs in the 10-15 per cent range can be found in the schedules of both countries on products traded across the border, or which would be traded if these duties were removed. Moreover, many tariffs are higher on processed and manufactured goods than on the materials from which these are made, which results in some exceptionally high levels of "effective protection" for the processed and manufactured products.

On both sides, there will probably be a need to phase out tariffs in certain sectors over a period of years, rather than immediately; and it is likely that the lists of products concerned, as well as the timetables for staging, will differ between the two countries. A case might be made for allowing Canada a somewhat longer time to dismantle its tariffs; adjusting to the removal of tariffs is likely to give rise to greater difficulties on the Canadian side because of the larger role of imports in the Canadian economy.

There will undoubtedly be difficulties in the way of removing some of the tariffs in the agricultural sector. While the most visible barriers to trade in this sector are non-tariff measures, there are nevertheless a significant number of tariffs on both sides on primary and processed food products for which the tariff has been the main instrument of protection. On the Canadian side the seasonal tariffs on horticultural products are likely to present sensitive issues. These seasonal tariffs have been justified by the shorter and later growing season in Canada, and may have to be accommodated in the new agreement.

The tariffs in the automotive sector will present another special case. Under the 1965 Automotive Agreement U.S. tariffs were removed on imports of Canadian motor vehicles and original parts, while on the Canadian side tariff-free imports from the United States were limited to producers of motor vehicles which met certain performance requirements. As it stands, the Automotive Agreement has worked well for both countries, and its operation is supported by the North American automotive industry. Certainly, the termination of the Agreement in the context of the new trade agreement would present difficult political as well as economic problems on the Canadian side. Perhaps means can be found to modify the Automotive Agreement in ways which would liberalize its operation while calling for a continuing review of its provisions to determine when and how its special features could be terminated or phased out on a mutually satisfactory basis.

The new trade agreement will need to contain provisions for appropriate rules of origin, because duty free treatment will doubtless be limited to goods with an agreed level of Canadian or American content. Also, rules of origin will be needed because the tariffs of the two countries are different on imports from third countries, and each will remain free to change these rates on third country imports.

Non-Tariff Barriers and Restrictions

There is such a wide variety of non-tariff barriers which impede or distort cross-border trade in goods and services that it is impossible to list all of them here, let alone suggest how individually they might be removed or modified so as to permit goods and services to flow more freely across the border, and improve economic efficiency and competitiveness in the two countries. Some are highly visible, such as U.S. quotas on imports of sugar and sugar products and Canada's prohibitions on imports of used automobiles and margarine. Others are much less visible, such as those arising from differing product standards or those embodied in differing regulatory regimes. There exist, as well, a variety of non-tariff barriers to trade across provincial and across state boundaries which can prevent imports (as well as domestic products) from moving freely within national Canadian and United States markets.

There are a number of non-tariff barriers which can impede or distort cross-border trade which are not in place primarily to provide protection for domestic producers, but have been introduced in support of broader political, strategic, social or cultural objectives. Some of these may be particularly difficult to remove or to modify, at least in the short run, without abandoning the domestic policies they are designed to serve. In this category could fall certain areas of defence purchasing, especially in the United States, and certain of the Canadian programs to support domestic cultural industries or to promote development in disadvantaged regions, as could a range of programs in both countries to support farm prices and incomes.

In two areas there are non-tariff trade barriers which would seem to be especially important for the new agreement to cover in one way or another.

One of these includes the barriers embodied in federal government purchasing policies. There already exists a GATT code on government procurement, adopted as an outcome of the Tokyo Round and somewhat improved since that time. The commitments of the two countries under this code could be extended to cover all or most of the procurement by each federal government so as to place enterprises in the other country on an equal footing; and it seems also important that these new bilateral commitments should be extended as far as possible into the large and important area of defence purchasing. It would, of course, be desirable to include some or all of the procurement by provincial and state governments under the new bilateral arrangements. If this is not possible immediately, the agreement could provide for processes by which provincial and state government procurement could be included at a later time. But a meaningful and comprehensive arrangement involving initially only the two federal governments would, in itself, be a major move towards bilateral trade liberalization.

Agriculture is a second area where there appears to be scope for the removal or relaxation of a number of non-tariff barriers under the agreement, and a process initiated for further trade liberalization in the future. For example, even without significant changes in existing support programs but with some arrangements on the pricing of exports, a number of the barriers to cross-border trade in manufactured dairy products, such as those applying to butter and cheese, might be removed or substantially reduced; there may also be scope for liberalizing Canadian restrictions on imports from the United States of poultry and eggs as well as grains and their products; and protective restrictions may exist or be threatened by either country on cross-border trade in meat might be terminated. On the U.S. side, restrictions on imports from Canada of sugar and products containing sugar have been intensified in recent years, and their relaxation would represent an important contribution to bilateral trade liberalization. The bilateral negotiations should also look for ways of minimizing adverse affects on their trade with third countries arising from each other's domestic and international agricultural policies, for example, the impact on Canada of the new U.S. farm legislation. The overall objective should be an increase in the competitiveness and efficiency of agriculture in both countries.

Negotiations in "New" Areas

It is generally recognized that the new agreement should go beyond the traditional areas covered by trade agreements and extend into the so-called "new" areas, such as trade in services, the protection of intellectual property and trade-related private investment.

Trade in services is an area of trade which has not so far been covered by GATT rules, and both Canada and the United States have called for the inclusion of services in the new round of multilateral trade negotiations. However, the process of these GATT negotiations and their outcome remains quite uncertain. Successful efforts by Canada and the United States to deal with this important and growing area of trade under the bilateral agreement could be a model and precedent for the multilateral negotiations under GATT.

There are recognized difficulties in approaching negotiations on trade in services. These include the large number of areas which are involved, the different characteristics of trade in these areas and of the issues involved, and the lack of reliable data on which to base efforts at international rule-making. It has been suggested that in these circumstances, the initial attempt should be to reach agreement on a set of principles or guidelines; these could then provide a framework within which action could be taken to liberalize trade in particular sectors of services, and agreement reached on rules covering trade in particular sectors.

In the light of the history of regulatory development in services sectors in the two countries, many of the practices of state and provincial governments will have to be included within the scope of the bilateral arrangements, as progress is made on the guidelines or in sector-specific agreements.

Protection of intellectual property. The United States has already made known that it will seek provisions in the bilateral agreement, as well as in the outcome of the multilateral GATT negotiations, aimed at better protection of intellectual property rights such as trade marks, patents and copyrights, and better protection against counterfeiting. One objective is presumably to reduce trade-distorting practices arising from the inadequate protection of intellectual property; another would be to give greater security of access to technology in the future.

Private investment. A third area where the United States has signaled a particular interest, both in the bilateral and the multilateral contexts, is in establishing a framework of rules within which private investment can flow with a minimum of interference by governments. Canada should also have a substantial interest in creating such new rules, because of the importance of two-way flows of private investment to the Canadian economy. One set of issues involves the use of "performance requirements" as a condition of approval for investment plans. Another involves the "right of establishment", which has particular relevance in many areas of services.

Trade Remedy (Contingent Protection) Systems

The bilateral negotiations can hardly fail to cover the use by the two countries of their so-called "trade remedy" or "contingent protection" systems. These include their legislation and practices governing the use of countervailing duties and anti-dumping duties to counter subsidized and dumped imports; so-called "escape-clause" or "safeguard" measures to limit sudden flows of imports which injure domestic producers; and some other import restrictive measures designed to counter damage to their trade interests by the actions of other countries. Although these trade remedy systems are authorized and disciplined by GATT rules, their use to deal with cross-border trade – or their abuse – has given rise to serious frictions between Canada and the United States, especially in the past several years. In Canada, it is widely believed that the U.S. trade remedy systems are being used for mainly protectionist purposes, and to harass Canadian competitors. Some petitions verge on the frivolous, such as complaints about exports of Canadian cut flowers and raspberries. It is evident that the very existence of these systems, and the threat of their use, can serve to inhibit or distort patterns of investment; for example, Canadian firms may be induced to establish plants on the U.S. side rather than in Canada simply in order to avoid the threat that exports from a plant in Canada could become subject to special duties or other restrictions at some future time.

Under conditions of free trade or near-free trade in the future, it is possible that some of the measures provided by these systems would be used or threatened less often. For example, as and when customs duties are abolished there will be fewer opportunities for firms to sell their products at dumped prices across the border, and "predatory pricing" or price discrimination practices could be governed by the normal competition laws of the two countries. Similarly, intellectual property rights could be protected by the laws of the two countries governing copyrights, patents and trade marks.

There seem to be three ways in which contingent protection/ trade remedy systems could be dealt with in the bilateral negotiations.

The first would be simply to abolish the use of these trade remedy systems by both Canada and the United States, as they apply to cross-border trade. But there could well be opposition in both countries to such an ambitious step at least in the short run. U.S. officials have warned that it would be unrealistic to expect the Congress to agree to any kind of blanket exemption for Canada.

The second and best approach would be for the two countries to set aside their current trade remedy legislation, as applied to cross-border trade, to identify jointly the kinds of problems which would arise on both sides of the border when a free-trade agreement is in place, and then to develop a completely new set of bilateral rules to deal with such problems in an effective and mutually satisfactory way. Such an approach would explicitly recognize that the current GATT-based rules would not be responsive to the circumstances of a free trade area to be established between Canada and the U.S.; it would recognize the unique size and complexity of the trade and economic relationships between the two countries; and because the approach would be focussed on the particular features of cross-border trade it would likely produce arrangements on both sides which would be a significant improvement over what is now in place.

The third approach, although less wide ranging, might be appropriate during a transitional period. This would involve amending the two current systems to make them work better, and reduce the severity of the trade frictions which have been a feature of Canada-U.S. relations in recent years.

Alternatives to existing trade remedy practices will need to be found. An agreement which fails to change the present systems would be unlikely to find much support in Canada. Uncertainties about access to markets would persist which would seriously undermine the basic purpose of the agreement; and the kind of bilateral frictions over important trade issues which have existed over the past several years would continue, undermining other areas of Canada-U.S. relations.

New Institutional Arrangements

The process of removing tariffs and other barriers to cross-border trade, assuring that they are not reinstated in the future, and avoiding the emergence of new barriers could be greatly assisted by the creation by the agreement of new permanent joint institutional arrangements. Such arrangements could also be helpful in the avoidance of future trade disputes and in helping to resolve them when they arise. The creation of such new arrangements would form an important and key element in the new agreement.

It is suggested here that the new trade agreement should assign political-level responsibility for its operation to the Canadian minister of international trade and the U.S. trade representative, who carry primary responsibility for trade policy and negotiations in the two countries. More easily than a large group of ministers and secretaries, they could keep in close and regular contact and consult together at short notice on emerging problems and issues. Also, by focussing political responsibility for the operation of the agreement more narrowly, consultations on both sides with provincial and state authorities as well as with the private sector would be facilitated.

In addition, it is suggested that the new agreement should provide for the creation of an independent Joint Trade Commission to assist in its implementation and operation, and perhaps also assist in the management of other trade-related issues outside the strict confines of the agreement. Its creation would be in line with well established and unique patterns of Canada-U.S. cooperation in other areas, as exemplified by the International Joint Commission (IJC) whose functions, structure and procedures could serve as a model. The IJC was created by the Boundary Waters Treaty of 1909 and since then has provided invaluable service in helping the two countries deal with problems arising from the use of boundary waters, as well as helping protect the environment in boundary areas.

Following precedents established by the 1909 Boundary Waters Treaty and the International Joint Commission created by this Treaty, the proposed Joint Trade Commission might be composed of six Commissioners, three appointed by each side on the basis of their qualifications to deal with trade and related issues, including both the economic and the legal aspects of these issues. The Commission could be headed by Canadian and U.S. co-chairmen and maintain separate offices in the two capitals.

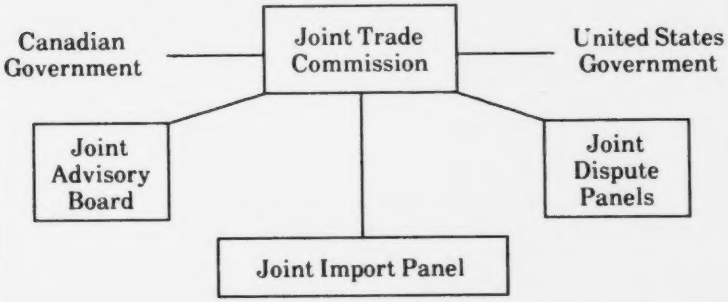
The new Trade Commission could be assisted by a joint advisory board, drawn from departments of the two federal governments, from provincial and state governments, and from the private sector in the two countries, representing the various functional, sectoral and geographic interests involved in the Canada-U.S. trade relationship.

The trade agreement could establish within the framework of the Commission procedures analogous to those in GATT, involving the establishment from time to time, as the need may arise, of dispute panels composed of specialists, say three or five in number, appointed by the Joint Trade Commission in consultation with the two governments to investigate and make recommendations regarding the resolution of particular disputes. It might not be necessary for the two governments to give the proposed Joint Trade Commission standing authority for the binding arbitration of trade disputes, which could raise difficult constitutional and legal issues in both countries, including difficulties on the Canadian side pertaining to federal-provincial jurisdiction. However, the Commission could be empowered to arbitrate trade disputes in particular circumstances, by agreement of the two parties. In any event, the recommendations of such a Commission could be expected to carry considerable authority.

As noted earlier, some of the most difficult bilateral trade issues, especially for Canada, arise from the application of anti-dumping, countervailing duty and "safeguard" import systems to cross-border trade. These systems are likely to be changed by the new agreement in one way or another, as they apply to cross-border trade. Depending on the outcome of the negotiations, it may be desirable for the new agreement to contain provisions which would require *joint* investigations by the new Trade Commission of allegations of unfair subsidization of exports and of dumping of exports, as well as *joint* determinations of injury as a condition for imposing anti-dumping, countervailing duties or safeguard measures on exports of goods or services from one country to the other. For this purpose the new Trade Commission could be authorized to create, as needed, "joint import panels", to carry out detailed investigations.

The box below suggests the structure of the joint institutional arrangements outlined above.

**STRUCTURE OF
JOINT TRADE COMMISSION**



Accommodation with the GATT System

An agreement which led to the removal of tariffs and other barriers to cross-border trade between Canada and the United States could not fail to influence the new round of multilateral trade negotiations under GATT. It would represent, in itself, a large step towards the liberalization of world trade, in view of the massive two-way flow of Canada-U.S. trade. It would also create a model and precedent for the improvement of the GATT rules which discipline the use of tariffs and other trade restrictive measures. But at the same time, the removal of barriers to cross-border trade on a bilateral basis could give rise to difficulties in the relationships of the two countries with their other trading partners, even though their actions might be perfectly compatible with the rules of GATT Article XXIV which govern the formation of free trade areas and customs unions.

Despite the scope provided by GATT Article XXIV for a free trade agreement between Canada and the United States, there could be concerns in the two countries as well as in other countries that such an agreement could result in a weakening of the GATT system and cause damage to third country trade relationships. To allay such apprehensions it is suggested that the two governments should clarify at some early stage, jointly or separately, that it is not their intention to establish permanent or long-term tariff or trade preferences between the two countries; that each stands ready to consult with third countries on trade problems for them which may be created by the agreement; and that during the new round of GATT negotiations, on the basis of balanced reciprocity, both countries would be prepared to exchange with other GATT members on a most-favoured-nation basis many or all of the benefits exchanged bilaterally under the proposed agreement.

Conclusion

The objectives of removing tariffs and other barriers to cross-border Canada-United States trade in goods and services are essentially to improve the efficiency and competitiveness of the two economies, stimulate productivity and economic growth, and open new opportunities for enterprise and initiative. The process has been under way since before the Second World War, and particularly since then within the framework of GATT. While the proposed new agreement would represent for both countries a momentous development in their trade relationship, the agreement would also represent an evolution of past policies rather than a departure from them. For both countries, the new bilateral agreement would not represent an alternative to GATT in their bilateral trade relationship, but would supplement and broaden their rights and obligations under GATT.

Successful conclusion of the agreement will require it to be satisfactory to both countries, involving a mutual balance of advantage and the acceptance by each of disciplines and rules over its own trade and economic policies in exchange for the acceptance of similar disciplines and rules by the other. The resulting exchange of rights and obligations would extend beyond those contained in the GATT and other agreements, as these now stand, but would not differ from them in their nature. It is difficult to see how a bilateral agreement of this kind, freely entered into, would represent a relinquishment of sovereignty by either country which would differ from the order of obligations they have accepted for many years under GATT.

An essential feature of a new Canada-United States trade agreement will be to embody in it firm commitments by the two governments to ensure its long-term durability and to prevent the erosion of its terms by subsequent action on either side. Canada has a particular need for certainty and confidence regarding the permanence of the new arrangements, given the extent of the adjustment which will be required in its economy.

At this point, failure to achieve a successful outcome of the negotiations could not fail to have serious consequences for broader Canada-United States relations; it would generate new protectionist trade measures on both sides of the border; and it would cast doubts on the eventual success of the broader multilateral negotiations in GATT.

Parizeau on Trade

Mr. Parizeau spoke at the conference, on "Direct Investment and Free Trade: A Prospective". He lectured informally from notes. Unfortunately, we do not have a transcript of his address. However, immediately after his presentation, he gave an interview to one of us (Velk), touching upon many of the topics investigated at McGill's free trade symposium. Below we provide a very lightly edited version of that discussion. (Eds.)

Q: Should we have free trade, Mr. Parizeau?

A: With the United States? – Yes, indeed. I think we should try to get an agreement which is as wide as possible, as rapidly as possible.

Q: What will it mean for the average Quebecer?

A: Probably he'll gain access to a much larger market than anything that was available until now. And insofar as he's probably more competitive now, certainly more competitive, in a number of branches and areas than he was some years back, I think he has a fighting chance to, in effect, penetrate what is a huge market.

Q: What effect will free trade have on the balance of power, both political and economic, among the provinces? – And what will it mean for Quebec's independent minded people?

A: There are several aspects to this question. (Interviewer Velk here interjects: "We'll take them one at a time".)

I think that one has to look at this a bit differently, as to whether one is in Ontario or Quebec. I recognize that some Ontarians have qualms about free trade with the United States – have reservations about it. After all, U.S. subsidiaries are far more important in the Ontario economy than they are in the economy of Quebec. A great deal of the growth of the Ontario economy has been due to investment, or policy followed by U.S. subsidiaries. In a free trade environment – a wide free trade environment – it's not all that obvious that the expansion of U.S. subsidiaries in Ontario would take place quite in the same way. I wouldn't say that the Americans would forthright withdraw their subsidiaries. But they might not have the sort of rate of expansion that they've had over the last few years. It's not obvious either, that head offices in New York or Chicago would allow Canadian plants to compete with their other plants in the U.S. So I can understand that there be some reticences.

In Quebec, of course, the problem is quite different. A very large segment of our industries have never interested Americans. There are much fewer U.S. subsidiaries. And in the last 10 years or so, we've seen a remarkable development of indigenous business that started to export to the U.S. when the Canadian dollar dropped. They found the going "rather nice" in the United States. They now want a bigger piece of the action. They're in no way hindered by head offices in New York or Chicago, and the more of the action they can have, the better for them.

Q: What about Quebec's weak industries . . . the textile makers, the shoe makers, the clothing makers?

A: Well, these people also attempted to sell in the United States over the last few years, because the exchange rate was low. And they found that it was possible. It is rather remarkable to see, for instance, what the furniture industry is now doing in the U.S. market. The various attempts to sell clothing – of good quality – in the New York market have been rather astounding. In other words, a number of these people have the impression that while they couldn't support direct competition with Taiwan or Korea, in the U.S. market – Yes, they think they can.

Q: What about independence and free trade – for Quebec?

A: For a Sovereignist like myself, this is not a hindrance . . . . except that sovereignty association would have a very different meaning. Once a free trade area in North America has been set up, no premier of other provinces could come to Quebec in the midst of a referendum campaign and say "if you vote this way, no commercial deal with us." I suppose we'd say, (chuckle) "It really doesn't matter, old boy."

Q: So, oddly, your position is you get more cultural freedom, and in some sense, political freedom, out of free trade than you have without it?

A: Not necessarily political freedom. It is difficult to define political freedom. This is something one has a little less, a little more, depending on how much one desires, within constraints, of course. Culturally speaking, it's very different of course, as far as francophones are concerned. The great cultural debate that takes place in the rest of Canada around that possible agreement with the United States hasn't the same intensity in Quebec at all. The language barrier is there, whether Americans or English Canadians are involved. It's not as acute. I doubt that many Francophones will figure themselves culturally threatened by an arrangement, a commercial arrangement with the United States.

Q: Some people have said that free trade, because it makes you richer, makes it easier to buy a special culture, or buy independent social programs, or even buy a certain degree of political manoeuvrability – that's all I meant by the word freedom (in the previous question - eds.). Do you go along with that – is that a reasonable argument?

A: Yes, in the sense that the field is a bit more open.

Q: Why do you think it is then, that so many people in Central Canada argue that culture is threatened, and that social programs are threatened, and that even sometimes political independence is threatened?

A: Culturally speaking, I can understand. I mean after all, the language is the same. Start to withdraw various regulations of the CRTC, and programming among Canadian TV stations – English speaking TV stations – could change rapidly. I can understand that English Canadians feel the cultural impact much more than Francophones do.

With respect to social programs .... some have raised hell in Canada over this, and it was uncalled for. A common market has existed in Western Europe for 30 years now. These countries have very different social programs. And they've managed to keep their social programs quite different. I don't see that the common market has put pressures on these countries to align their social programs so as to be, shall we say, in closer competition. It just hasn't happened. I mean, where have we tried to find proof that because we would be in a free trade relation with the United States, our hospital programs or health programs would be jeopardized. This I think is uncalled for – it shouldn't be an argument.

Q: The United States is a big internal free trade zone, and Canada is to a lesser extent also. And yet inside the United States and inside Canada we've got big cultural differences and big social program differences too, and they weren't erased by the commercial activity that went on around them. So do you think that logic would extend to a North American commercial connection?

A: I think so. There have been fragmentations in terms of government, in terms of regulations, in terms of legislation. There's a considerable fragmentation in the U.S. between the states. That has existed for 200 years. In Canada, we know how fragmented in many ways the Canadian structure can be. And it has been that way for a hundred years. But why should a general free trade arrangement in North America suddenly change the rules of that game of fragmentation? I don't think that all fragmentation is useful, but in some cases, it does reflect political differences, orientations that are different, that have maintained themselves in Canada and the United States for a long long time. So let's face it, it's not because there would be a free trade arrangement in North America that suddenly all that has kept Canadians apart from each other in certain ways, or Americans apart from each other in other ways, will suddenly vanish. It just won't.

Q: Are there any dangers you see in the free trade arrangement?

A: Oh yes, there are dangers. I think very specifically in the way transition periods are negotiated. These are crucial. We don't talk enough about this, and I think we should. It's not at all the same for an industry to have say two or three years to adapt, or five or six, or ten. We should, I think, pay a great deal more attention to the adjustment processes that should be worked out by the government. What kind of help for modernization purposes or recycling or whatever, should be given to the labour force, should be offered to certain types of industries that might be particularly affected? I'm a bit wary not to see the Canadian government be a little more active in defining its position on these matters at the present time (March 18-19, 1987 - eds.) – I think it should.

Q: Is there anything that should be "off the table" – That should not be negotiated about at all?

A: Discussing what should be off the table has been an exercise in semantics. In *any* major negotiation, where there are 30, 40, or 60 possible angles or questions, each negotiator will obviously try to cover the whole field, and see how the other part reacts. The problem is not to determine whether something is on the table, but how our negotiator reacts to what is on the table: that's what I'm interested in, not the fact that the American negotiator should try to put something on the table.

Q: Is Mulroney strong enough to pull this off?

A: Yes, I think the government, because it is the government has the strength to pull this off. Quite irrespective of what the Gallup polls can say about voting intentions, the government has a very large majority in the House; it still has some time before the next election – if it wants to pull it off, it will.

Q: Would it be a big set-back if the talks fail?

A: I think it would. But there again, in any negotiation, it depends how and whether points of view can be reconciled on a wide variety of things. I'd be rather distressed if they failed. But, in any negotiation, there is always that risk.

Q: Thank you, Mr. Parizeau.

V

Distinguished Conference Speakers

Address

The Honourable Thomas M.T. Niles
United States Ambassador to Canada

I thought I would talk a little bit about the U.S. perspective on the negotiations with Canada, and give you a few thoughts on where I think the process is going, and how the eventual agreement which I anticipate to emerge from the negotiations will be dealt with by the United States Congress – as it must be once we conclude the negotiations. At the end of this I would be delighted to respond to any questions you might have on the points I make, or other aspects of the U.S./Canada trade situation today and in the months ahead.

As I've been quoted before, you won't be surprised if I say today that I'm quite optimistic that we will indeed achieve agreement on a free trade agreement in these negotiations, probably by the end of the summer; in time to allow the President to send the agreement to the Congress within the time window for Congressional approval on the so-called fast track negotiating authority. The beauty of that negotiating authority is that it does require both Committees, Ways and Means and Finance, to act within a certain period of time, and it does require both Houses of Congress to act within a certain period of time, and it also requires an up or down vote on the entire package.

From the point of view of foreign trade partners, negotiating partners, that is a very big advantage, because you don't have to renegotiate the agreement with Congress after you've negotiated with the Executive Branch. The legislative authority does expire on the third of January of next year, so under the terms of the legislation (according to calculations by experts on the Committee staff) we need to be ready somewhere around the third of October of this year to present the legislation covering the agreement to the two Committees.

We do have a number of tough issues remaining before us. Although the overall outlines, I think, of the agreement are pretty clear to both sides, some heavy negotiating is likely as we move through the summer and some tough decisions are going to be required on both sides. But, personally, I feel that there is the political will and the commitment on the part of both governments – certainly it is there on the part of my government – to see this process through. We benefit from the fact that the two parties do approach the negotiations with some share objectives, with some very powerful shared interests. We have problems in the sense that the parties do approach the negotiations with some differing concerns and differing objectives. But as I've suggested, I believe that we will be able to find solutions to the most pressing problems.

I do believe that, at the end of the day, we will have a comprehensive agreement. It is quite possible, indeed likely, that some issues will be left for a later stage, that we won't be able to remove each and every barrier to trade between the United States and Canada in these negotiations. I think we will be able to make a very sizeable cut in those barriers and establish a framework within which future progress will be possible. The debate in Canada, of course, is a very interesting one. We have seen the two-day session in the House of Commons in which many of the issues were discussed. The debate in the United States has not yet begun with quite the same degree of intensity, but we do see increasing interest in the United States in these negotiations, on the part of industry, on the part of labour, on the part of interest groups of one sort or another, and of course most importantly, on the part of the two Committees, Ways and Means and Finance, and other members of the House and Senate.

So we do see in the United States increasing interest in the process. The president cited it in his State of the Union message. The vice president, of course, was here shortly thereafter, and spoke with the prime minister about some of the trade issues. We have a Summit coming up in Ottawa on the fifth and sixth of April, in which trade will certainly be discussed. We have a fairly intensive schedule of visits by Members of Congress at least tentatively planned in the months ahead. So we do see intensifying interest. The United States media is beginning to show interest in the negotiations. You may have seen the front-page article in the *New York Times* earlier this week. Other journals such as the *Wall Street Journal* and the *Washington Post* are also beginning to focus on these negotiations. So as the process goes ahead, I think we will see more and more interest.

I thought it would be useful also if I could talk a bit about some of the arguments raised against an agreement; to examine these arguments. I think one of the positive aspects of the discussion under way in Canada and in the United States is that it will force opponents of a free trade agreement to state their positions clearly and to permit people on both sides of the border to examine rigorously some of the propositions that are being raised as arguments against the free trade agreement between the United States and Canada. I think it will be an opportunity for supporters of a free trade agreement to put to the opponents the necessity of justifying their positions and offering a viable alternative.

Let's examine some of the alternatives that have been suggested. One, obviously, is the status quo. This is in a way a function of the old Southern rural expression, very familiar to me from my childhood, "If it ain't broke, don't fix it." This is an expression which was normally applied to agricultural machinery. And it made sense if you were applying it to agricultural machinery. I would argue that while the U.S./Canada trade relationship today certainly is not broken, it is in need of continual care and fixing, because the conditions within which the two countries trade, within which the two countries interact, are constantly changing. These conditions are in a state of enormous change, and the change is accelerating.

The status quo, in other words, is not really an alternative to a free-trade agreement – because the status quo is not going to be there next year. It would be pleasant, it would perhaps be agreeable, since both countries are reasonably prosperous today, to take a snapshot of the current conditions in the United States and Canada, the current employment structure, and say, "Well, let's just keep it that way. We have unemployment in the United States down to 6.7%, it's at 8.4% or 9.4% in Canada. That's too high, but let's not rock the boat because this is better than where we were." But the fact of the matter is, that even as we speak today and meet today at this conference, economic conditions are changing – not only in North America, but in a broader world economy. We in the United States and I would argue Canada, as an even more active participant in the international division of labour than the United States in terms of the share of trade in your GNP, simply can't afford to stand still. We have to adjust with and try to keep, if we can, a little bit ahead of the process. So in my view the status quo situation that we are in is simply not a viable alternative.

Another alternative that has been suggested to bilateral trade arrangements between the United States and Canada is the GATT process. This is a very important process for both of us. But I think that those of us who watched, for example, the Tokyo Round, and particularly those of us who were engaged in the process of getting what I guess will be called the Uruguay Round under way, are wary of this. Those of us who are familiar with the complexity of that process and the complexity of the negotiations which we face would agree with me when I say that while we can expect some significant benefits from the Uruguay Round, if things go well, those benefits are going to come fairly late in the 1990s. And for countries such as the United States and Canada, those benefits are not going to be as direct as some might suggest.

They will not, for example, really affect too much our bilateral relationships. They will be more important to the United States than Canada as we look at third markets. As we deal for example in the international services business, we hope that we will be able to gain significant advantages from the Uruguay Round. As we, as agricultural exporters, try to compete with the subsidies of the European Community, we hope that as a result of greater discipline in agricultural trade coming from the Uruguay Round, we will have an easier time of it, or at least not as bad a time of it as we've had in the last two or three years.

But bilaterally, the effects are not likely to be too great. The same is true in certain other areas of concern to the United States and Canada. The Uruguay Round, important though it is, will have a much greater impact on our relations with third countries than that Round is likely to have on bilateral U.S./Canada trade issues. So we do have, it seems to me, a need to work out our bilateral trading relationship in the bilateral context; to make the kinds of adjustments that need to be made on a bilateral basis; and then, quite appropriately, complement that as we hope to do in the GATT process on a multilateral basis aiming as I think we should at improvements for both countries in third markets—other developed country markets, particularly the LDC markets.

The other alternative that has been suggested to a comprehensive free trade arrangement between the United States and Canada is the sectoral approach. We were initially attracted to that, and as some of you may know the two governments did examine that aspect or that possibility in the 1983-84 period. We found, to our disappointment but I think realistically we recognized what we were against, that there really wasn't much to be done on the sectoral basis. Some of us, of course, were initially attracted to the analogy with the Auto Pact, an extraordinarily successful example of what sectoral free trade can do for the United States and Canada, or any two countries. But I think we at the end of the day came to the recognition that the automobile industry in North America was a unique case. We could not look for analogues in other areas and expect that because we were able to expand automobile trade from around a billion dollars in 1964 to 40 billion dollars in 1985 or 1986, that we could do the same thing or anything close to it in other sectors. They simply weren't there. So the sectoral approach which was examined at a slightly earlier stage was found to be wanting.

Of course, there are obviously other alternatives to a comprehensive free trade agreement, but those are the ones which have been the most widely presented. From our point of view, none of them really answers what we see as being the most pressing needs of the two countries today. Another virtue of the debate that is going on in Canada, and I think will soon be joined in the United States both on U.S./Canada trade issues and I think more broadly on the U.S. trade bill which will certainly emerge from this session of Congress, is a discussion of the virtues and drawbacks or negative aspects of protectionism.

Trade protectionism is a subject which is poorly understood in economic terms, primarily because the attraction of protecting oneself against unfair competition is a very great one both in political terms and sort of rhetorical terms. Governments, after all, are supposed to protect their citizens. Every government is supposed to protect its industry against unfair competition. And this idea that we must somehow protect ourselves against the outside world sometimes does gain a great deal of attraction. Of course when you have, as the United States has, an enormous merchandise trade deficit, 170 billion dollars or so, the attraction of protectionism is very great. But I hope that one of the results of this debate in the United States, and the debate that I'm sure will be joined in Canada as well, on the future of our two countries and the economic relationship between us, will be to expose once and for all the tremendous negative side of protectionism and what it can do to an economy.

I think that for us in the United States to be very productive, and I hope we do this, we must analyze what our experience has been in the period following 1959-60 and to take a look at some of the industries in the United States that have been the target of the greatest protection from the government and the beneficiaries of the greatest degree of protection from imports. If you look today at the weakest sectors of the United States economy, bar none, these are the sectors which we have sought over the years to protect most assiduously, and for which we have provided the greatest protection.

Steel. We started our steel program, as I recall it now, with the Japanese – restraining Japanese steel exports to the United States in the early 1960s with numerical or quantitative restrictions on Japanese exports to the United States. What we found, of course, was that it didn't help the steel industry very much. The steel industry was sheltered from competition. Steel consumers in the United States, on the other hand, were forced to pay higher prices for somewhat inferior products. Therefore, consumers and users of steel in the United States, the automobile industry for example, were less competitive against Japanese automobile producers who were able to buy their steel from Japanese producers and presumably were not victims of protectionism in the Japanese economy – although in some respects the Japanese economy is very protected, as we know. The cost of this to the United States economy in the ensuing period has been enormous, and of course today we have a steel industry characterized by enormous shutdowns of plants, major cuts in production, major cuts in employment, and still a serious problem with imports.

Now, some of those imports are subsidized, there is no question about it. We look at the developing countries and we find steel industries in some of them that are subsidized to an outrageous degree. The European steel industry is subsidized to a very, very considerable extent. I'm not quite sure how you deal with this in the political environment that you have in a country, democratic societies such as yours or ours. You do have the opportunity for workers, management, labour, and other groups to petition, as they have the right to do, against unfair trading practices. But the truth of the matter is that our experience with protectionism in the United States very clearly demonstrates that we've paid a tremendous price in terms of the competitiveness of the United States economy in almost every instance where a company or an industry has been afforded protection. As I've said before, those industries which have been most protected are the weakest branches of the United States economy today.

It is a matter of concern, I think, to many people in the United States that some of those areas which were previously thought of as being the cutting edge of new technology are now seeking protection as well. Even though, again, we do see unfair trading practices on the part of many of our foreign competitors; an unwillingness on the part of the Japanese to make some of the adjustments which I think that most of their trading partners feel Japan should make in the current international environment. But protectionism has been a false god in the United States and our economy is weaker as a result of what we've done. It certainly is my hope that the great debate that is now taking place in Congress . . . will expose once and for all some of the fallacies of the argument.

There are, of course, cases to prove the contrary point. Those of you who read yesterday's *New York Times* notices, perhaps, an article on the Harley-Davidson motorcycle company, which tends to disprove the point that I've been making. Harley-Davidson was given protection in 1983 against the onslaught of the Japanese and now today says it no longer needs the protection that it has because it's been able through that protection to recoup market share and become more profitable. I don't know whether that's the exception that proves the rule, but it is certainly the only case I can think of in recent experience in the United States. On the other hand, we've had quite a few cases where a company given protection actually emerged from the process at the end of the day stronger and then in fact said to the government, "Well, that was fine, but we need more, because our foreign competitors, rather than becoming less aggressive have become more aggressive, and we are in even worse shape today than we were two, three or four years ago when the process began."

It's an insidious process; it's a dangerous one. I think to the extent that we in our own bilateral relationship can establish an atmosphere within which a more competitive approach to foreign trade rather than a protected approach to foreign trade problems is adopted on both sides of the border, that we would be better able to deal not only with each other but in the very difficult international trading environment in which the United States and Canada have to exist today.

So, I am optimistic. I think that we have some big prospects ahead. I've seen all of the projections, the econometric models about how much the United States and Canada would gain as opposed to, let's say, the status quo, which I've suggested is no longer going to be with us tomorrow. But in any case, I've seen the projections of how much we would gain from free trade: 7%-10% GNP over a certain period of time. The gains are there; I think the opportunities are there. We have an interesting historical experience in North America, where we've had opportunities in the past to take the step that is before us and we've shied away from it. We had 10 years of free trade in the 19th century in which, unfortunately, the United States stepped away from for political rather than economic reasons. We've had two treaties or two agreements negotiated in this century which Canada chose not to move ahead with. I think we have a unique chance again. It is not necessarily the only chance we will ever have again, but I think it would be a real pity if for whatever reason on one side or the other the governments were unable or the political systems were unable to move ahead and take advantage of this opportunity.

Why Canada Needs Free Trade

The Honourable Robert Layton
Member of Parliament

It is a great honour and special pleasure for me to be here today with all of you, to participate in an historic debate, one which is vital to the future of our economic relationship.

The organizers could not have selected a more appropriate time to hold this conference in the light of initiatives taken by our prime minister this week in Ottawa, to focus government attention and priority on the free trade talks. I am proud to be able to share this occasion, with you, on behalf of the honourable Pat Carney, Minister of Trade, and all the government.

When I get questions about the Canada-U.S. trade negotiations, they are usually along the lines, "What are the talks all about?" "What is going on?" "What is coming down?" Canadians keep saying, "Tell me."

OK. *One*, Canada is trying to work its way out of a bind. We are living beyond our means. All governments are in deficit. We are not as productive or as competitive as we need to be. Our real gross national product is not rising fast enough. We have to find ways to pay the bills by expanding our economy, employment and income.

Two. Trade is a major means of creating the wealth to increase investment, production, jobs and pay cheques. Removing barriers to trade is the key to the process.

That means, *three*, we've got to secure and enhance our export markets. Why? Because our internal market is not big enough to sustain our life style. Thirty per cent of our income already depends on selling our goods and services outside the country; three million jobs depend on this. Two million jobs depend on sales to the U.S., to which we send nearly 80 per cent of our exports. This market is shrinking. We are vulnerable.

We want to improve our sales to the rest of the world. And we are spending money to promote exports in Europe and the Pacific Rim. We are also working to eliminate trade barriers in the multilateral talks under the General Agreement on Tariffs and Trade (GATT) as a route to economic expansion and improved living standards. These negotiations are an important element in securing an advantageous long-term trading position for Canada. But let's fact it, our life-blood is our export market south of the border.

We have had a good trading relationship, by and large, with the U.S. So have they with us. We are each others' best customers. We do a mutual trade of $160 billion a year, the biggest volume in the world.

So what are bilateral trade negotiations with the U.S. all about? Let me tell you. Although tariff barriers between us have been substantially reduced as a result of multilateral trade negotiations over the years since WWII, we still do not have secure access to the American market. So, given the importance to us of the American market, it is obviously a good idea to try to secure, enhance and enshrine our mutual economic relationship in a *long term, comprehensive binding* trade treaty with the U.S.

The Americans also think it is a good idea to consolidate their access to their biggest export market. That is why Prime Minister Mulroney and President Reagan initiated negotiations to reach "the broadest possible package of mutually beneficial reductions in barriers to trade in goods and services".

In general, that is what it's all about. But let's get more specific.

The conventional objective of trade liberalization – mutual reduction and elimination of tariffs, agreed rules of origin and improved customs procedures, is central. Eighty per cent of our goods now enter the U.S. duty free; 70 per cent of their exports to us are exempt from tariffs. But free and easy entry for the remainder is significant to both sides.

If that were all it was about, maybe the negotiations would not be too difficult. Further tariff liberalization may happen over time anyway under the new GATT Round of negotiations in which Canada is an active participant. But that protracted process won't solve our more immediate problems.

More important is the bilateral bargaining with the U.S., which includes contingency protection measures, a host of non-tariff barriers to trade, and for the first time, the negotiation between us of rules governing trade in services, investment measures and protection of intellectual property rights, ie. patents, copyrights and trademarks. These are all issues of market access for both of us. In addition we are talking about better dispute settlement mechanisms (even with a free trade agreement we are going to have sectoral problems given the size and complexity of Canada-U.S. trade) and the adjustment process involved in implementation of an agreement.

OK. Both sides want the elimination or reduction of tariffs – phased in over a transition period related to the adjustment problems of particular industries. Historically, the phase-in period would be 5 to 10 years. Nobody is going to be doused with a cold shower overnight, and the price of tariff concessions has to equal out in value.

Contingency protection is a big issue, along with what are called non-tariff barriers. Indeed, these are greater impediments to trade today than tariffs. The GATT allows its members to enact trade remedy laws enabling the imposition of anti-dumping duties, countervail duties and safeguard measures. Both sides have such legislation.

The Americans' recourse to these laws is an avenue of protectionism in the United States along which a costly tide of trade restrictions is surging. Trade remedy actions against Canada in recent years have already affected nearly $7 billion of our exports. We want a better way to deal mutually with the use of trade remedy measures, one that does not expose the parties completely to unilateral and capricious actions. Nobody's going to give up their legal rights in this regard in relation to dumping or safeguards. The heart of the matter are countervailing duties (imposed to offset government subsidies in the producing country).

To get a handle on this, the negotiators are going to have to define what constitutes "subsidy". This, I can tell you, is one of the toughest issues on the table right now. Changes in the application of U.S. trade laws are a top Canadian priority. The Americans fully understand that. They have made it clear that, in return, they want movement on our side on our industrial subsidy policies.

Our chief negotiator has acknowledged that to get what we want, we will have to respond – but the discipline on subsidy policies will have to be reciprocal. Moreover, if we do not get relief from current American contingency protection, he has stated clearly he will not recommend a deal to our government. This illustrates the give and take of the bargaining. It is tough and it is complex. Nobody said it would be easy. And the sectoral disputes which arise in the course of the negotiations – to wit, softwood lumber – though not on the table, do not make it easier.

But the bottom line is, if we cannot strike a deal that is good for Canada and Canadians in every region, there will be no deal. The prime minister has taken this position from the beginning.

The exercise, however, is not a zero sum game. If we can negotiate a pact it will be a win/win deal. That is the way the Americans see it too. The president, the U.S. trade representative and the chairman of the senate finance committee have stated they want to see it all come together this year. That should alleviate fears that we might be left standing at the altar.

In Ottawa in January Vice President Bush reiterated that "We view the free trade discussions as very important and very possible to bring to fruition". U.S. Commerce Secretary Baldridge confirmed this view a few days later. And in his state of the union message to congress, President Reagan raised the profile of the Canada-U.S. talks by describing them as the most important bilateral trade negotiations ever undertaken by the U.S.

Some Canadians also worry about a trade agreement with the U.S. infringing on our sovereignty, our independence, our cultural identity, our social policies. Any trade negotiation, by definition, involves mutual restraints on unilateral commercial policy. But let's remember, that is what we are talking about – not the slippery slope to political subjugation or cultural suicide.

Getting it together is what our chief negotiators are busy at. They have been meeting monthly for the last nine months and the pace is quickening now that they are into the nitty-gritty of detailed bargaining.

As in the multilateral GATT talks, these negotiations are functional in nature or horizontal if you will – not primarily sectoral. That is, they address the market access issues to which I have referred, both tariffs, and non-tariff barriers such as federal and provincial practices or regulations which interfere with trade.

In addition to security and predictability of access, both sides are interested in opening up government procurement and regulated markets. For Canada a gain of just one per cent in the American procurement market would be worth an additional $7.5 billion a year and more than 100,000 additional jobs.

To the extent possible we seek national treatment – similar treatment to that accorded U.S. producers – for our goods and services. We would expect to reciprocate appropriately. On its side the U.S. is interested in striking arrangements in the new areas of services investment and intellectual property. Both governments attach importance to agricultural trade liberalization. However, as agricultural issues, including new disciplines on agricultural export subsidies, are global in nature they are primarily a priority in the GATT Round.

Obviously, to deal realistically, practically and sensitively with trade liberalization in these functional areas and its impact on their respective interests, the negotiators have to do their sectoral homework. It is only in that sense the negotiations are sectoral, that is, they are both horizontal and vertical. Purely sectoral negotiations were tried five years ago and didn't take. In any event, such an approach tends toward managed trade arrangements. As we know the risk in single issue negotiations is that the big guy is likely to win.

Having said all that, one sector that is under study by a fact-finding group is the automotive industry, where the Auto Pact might be said to be the exception to the rule. It is the industry, not the pact itself, that is being looked at – not surprisingly since the industry accounts for a third of our mutual trade and has undergone dramatic change in North America in recent years. Nonetheless, any reference to automotive trade raises understandable concern in Canada about the preservation of the Auto Pact and its massive benefits to us. Let's get this matter right.

The Auto Pact is not on the bargaining table. The American chief negotiator hasn't raised the Auto Pact – he says his side hasn't even determined how to approach industry issues. Those being examined are outside the pact, such as third country manufacture, production subsidies to attract investments in plant, the aftermarket and duty remission.

We are not opening up the Pact. We are happy with it. It works well. If the Americans want to discuss the automotive industry, we will listen. If they have any constructive proposals for improving the trade which will increase production, jobs and income in Canada, we will consider them. But we are not going to bargain away the Auto Pact or its safeguards.

It was foreseen that during the course of the comprehensive negotiations there might well be – as there have been – sectoral trade disputes and restrictive measures. Difficult as they are they are not handled at the free trade table – a deliberate decision. Though the chief negotiators can hardly be unaware of the noise in the environment, their job is to soldier on, looking to the *long-term* benefits for both countries which will flow from a successful negotiation.

But the recurring trade irritants underline the desirability of achieving a better way for resolving disputes, another Canadian priority. From the outset, the negotiations have been evolving in three phases: exploratory, detailed and final. We are in phase two and the negotiations are progressing on track.

It is in the nature of such trade negotiations that the parties do not really know whether they have a deal until the end of the road – the final compromise, the final concession, the final crunch. That is because until that point the trade-offs – in a functional negotiation everything offsets everything else – cannot be finally weighed and agreed.

The final phase, if there is to be one, must be completed by the end of next September. That deadline is dictated by the necessity for the president to notify Congress 90 days in advance of the expiry of his "fast track" negotiating authority of his intent to enter into an agreement. This authority expires January 3, 1988.

Basically, this authority requires Congress to deal with the implementing legislation within 60 days thereafter by a "yea" or "nay" vote without amendment, a constraint of great import to Canada given the current mood of protectionism in the United States.

On the Canadian side, the prime minister and premiers have agreed to discuss at first ministers' meetings the procedures for governmental approval and implementation of any agreement. Only the federal government has jurisdiction to enter into an international trade accord. To the extent that any agreement involves matters of provincial jurisdiction, it will consider the method for its implementation.

What is a comprehensive trade deal going to do for us?

Well, the first part of the answer is that, given the forces of protectionism and the lack of certainty about access to a market of scale, the status quo exposes us to becoming the poor man of the industrial world. In fact, the quickly changing environment in the U.S. means there is no such thing as the status quo when it comes to Canada-U.S. trade. What an agreement will offer us is an ensured environment for investment, new productive plant, economies of scale and specialization, better productivity performance and better jobs, more secure jobs, jobs with a future.

High productivity means low inflation, more jobs, stronger economic growth and new wealth to finance our social, cultural and environmental goals. The link between productivity and jobs is direct: higher productivity leads to higher incomes, which in turn create additional spending power. This increased spending power leads to more jobs. The history of trade liberalization verifies the linkage. Over the last 40 years of GATT tariff reductions, our exports have multiplied ten times, our national wealth has more than tripled and the number of jobs has doubled.

A number of studies have been made of the benefits of securing access to the U.S. market, yielding various forecasts of the impact on employment depending on assumptions, though most project positive gains. The most recent is probably that of the Economic Council of Canada. In its October 1986 report *Changing Times*, it suggests that the overall gain from freer trade could be in the order of 3.6% growth in GNP by 1995. It predicts inflation would be lower and the gain in employment could be over 370,000 jobs.

The Council also looked at the risks of not having an agreement and continued U.S. protectionism. Under this scenario, the Council indicates real growth in GNP could be 5% less than projected, unemployment could rise 2.4%, and employment could decline by 525,000 jobs.

Any new trade deals with the U.S. or under GATT necessitate adjustment. That is inevitable in the give-and-take of negotiations. But adjustment is a constant feature of the Canadian economy in any event. There is already a high degree of mobility and adaptability in our labour markets. In any given year, about a fifth of our working-age population either leave or lose their jobs while at least as many find jobs.

The adjustment process will be eased by a deliberate phasing-in period. That will provide time to rationalize some sectors if necessary, help in the retraining of workers if that is needed and ensure that any potential damage is quickly overtaken by the much broader benefits to be drawn from an agreement.

A wide range of programs has been put in place by the government under the umbrella of the Canadian jobs strategy to facilitate labour adjustment. Extensive skills training and re-training assistance is available now and will be available in future to help workers exploit new opportunities, including those arising from freer trade. The industrial adjustment services run by Employment and Immigration Canada aids both employers and workers in identifying job opportunities and matching them up with the people who can do the job. Mobility and job-search assistance programs also help those contemplating a move to greener pastures.

The funds allocated each year to labour adjustment – $1.5 billion under the Canadian job strategy for 1986-1987 – play an important role in augmenting the dynamism that is built into our labour force. The government is committed to maintaining the social safety net that allows Canada to respond flexibly to changes in the global economy. A new trade agreement with the United States will add to this flexibility and open up the new opportunities for economic growth that are the best adjustment policy of all.

What the government is trying to do in its two-track trade negotiations is help solidify and strengthen Canada's base; to manage change which is the economic reality of today; to promote the production, jobs and income which sustain our physical, social and cultural well-being; and fortify our independence and national identity; and to build a stronger Canada in a stronger world.

The U.S.-Canadian Free Trade Negotiations: Historic Opportunity

Louis F. Laun
United States Assistant Secretary of Commerce for International Policy

I appreciate this opportunity to comment on the free trade negotiations. McGill University has assembled an impressive group of speakers to discuss an historical opportunity of the first order that our two countries are now negotiation: a U.S.-Canada free trade agreement or FTA.

We view Canada as a friend and ally – bound together by strong ties of trade and investment. We share common goals as partners in the multilateral trading system. We cooperate in many areas, including defence, air and surface transportation, energy trade and the control of strategic exports.

When speaking of the virtues or the problems of our individual economies, we sometimes forget the interdependence that has grown between the United States and Canada. In the trade area the U.S. usually accounts for over 70 per cent of Canada's total exports. Canada, in turn, takes over 20 per cent of U.S. exports. Often overlooked by Canadians is the fact that Canada has direct investments in the United States of over $17 billion. In short, we enjoy a close economic relationship.

Prime Minister Mulroney has shown strong leadership in initiating this debate by having the political courage to propose the free trade negotiations.

Initially, this extremely important issue received little play in the U.S. media. Most Americans were unaware that a trade agreement with Canada was being contemplated. One reason for this is that many Americans mistakenly assume that we already have free trade with Canada. My colleagues at the Commerce Department tell me that U.S. businesses are often surprised at the number of trade barriers that still exist between our two countries.

However, the administration and Congress have been taking this issue quite seriously for some time and media interest is also increasing. The *New York Times*, just this week, featured a very positive front page article on the FTA. Senator Bentsen's visit last December is testimony to how much importance the chairman of the Senate Finance Committee attaches to the FTA. Vice president Bush also visited Canada recently, and President Reagan will be here in early April to meet with the prime minister. The administration's cabinet-level economic policy council is now conducting monthly reviews of the FTA negotiations.

The administration is committed to the negotiations. In the president's words, the FTA would be a "landmark accomplishment, a cornerstone for future prosperity that would be heralded on both sides of the border". This was most recently re-emphasized in the president's state of the union address. Any agreement, however, will have to be in the mutual interest of both countries. As attention is increasingly focussed on the negotiations, through the media, and our consultations with the private sector and the Congress, our private sector is increasingly asking what economic benefits are in it for them.

As a trade official with the U.S. government, I welcome the prospect that our two nations may be able to significantly reduce barriers to trade in goods and services as the result of this Canadian initiative. The successful negotiation of a meaningful agreement would bring great economic benefits to both countries. The benefits to Canada would be proportionally greater because Canadian industry would secure access to a market 10 times larger. But from an economic standpoint, I see freer trade between our two countries, not as a zero-sum-game, in which one nation benefits at the expense of the other. I see it as a situation in which we both gain. Most U.S. and Canadian economists are convinced that such an agreement will increase GNP and employment in both of our countries.

Protectionism

In a relationship as close as ours there are bound to be trade and investment problems. Laws and regulations are different in our countries. These differences sometimes cause problems in our business relations. They force us to try to work harder to resolve our problems.

I often hear the charge that protectionism is running rampant in the U.S. But let's put this charge in perspective. The United States has been running massive trade deficits with the rest of the world, and our bilateral trade deficit with Canada has grown to impressive proportions in recent years. Ask yourselves what Canada would have done if faced with a global trade deficit of equal significance. I think the administration has done quite well in controlling protectionist pressures in light of these realities.

No country – including Canada – is without sin when it comes to protectionism. I would argue that Canadian trade barriers, by any objective measurement, are indeed higher than those maintained by the United States. For example: Canadian tariffs are twice as high as U.S. tariffs on average, and are among the highest maintained by any industrialized nation; Canada maintains quantitative restrictions on more categories of imports than does the U.S.; and Canada maintains numerous performance requirements on investors that distort trade flow.

Our view of Canada is coloured by your investment restrictions, by unequal intellectual property protection, by high tariffs on manufactured goods, by the different treatment of trade in services and finally by the disparity in the treatment of business activities by your provincial governments. Your view of the United States is shaped by your concerns with our trade remedies as they may affect your trade in such products as lumber and steel.

Canadians, and your negotiators, are concerned about what you call contingency protection and we view as including unfair-trade remedy measures. These are measures that countries are permitted to take under the GATT to defend their industries against imports that are unfairly subsidized or dumped. Canada and the U.S. have similar legislation in this area. In fact the Canadian government recently imposed a countervailing duty of a stunning 55 per cent of value on imports of U.S. corn. While I will leave it to our secretary of agriculture to address the merits of the Canadian action, you can be sure there are some unhappy farmers in the United States and some unhappy consumers in Canada.

The administration and Congress will not accept any proposal that prevents us from using our laws to offset subsidized, dumped or other unfairly traded products. However, we are prepared to consider Canadian proposals that would be based on greater discipline in these areas. Congress will be very difficult to convince. But we are prepared to look at the issue in this context.

The FTA

With bilateral trade of $114 billion there are bound to be occasional trade disputes that flare up. The question before us is: "How do we best manage our trade and investment relations into the next century?" I think the FTA offers an historic opportunity to put our economic relations on a more sound and secure footing.

As I begin my discussion of the FTA. I remember that someone once said: "I think there are two areas where new ideas are dangerous – economics and sex. By and large its all been tried before, and, if it's new, it's probably illegal, or dangerous, or unhealthy." Well, free trade is not a new economic idea but one that has been around for a long time, and when it has been put into practice it has brought major economic benefits.

Historically the modern nation-state prospered largely because parochial trade barriers between small groups were eliminated. In the latter half of the twentieth century, we witnessed the growth of Europe into an economic power, out of the rubble of the second world war. Largely as a result of the economic integration, and removal of trade barriers, brought about by the European Common Market. More recently, Australia and New Zealand established a free trade area in the early 1980s. These free trade experiences have all led to higher levels of economic activity and productivity. None of these experiences has led to loss of sovereignty or national identity of the member states. In fact, by strengthening their economies, their political independence and national identities have been enhanced.

Years ago when President Kennedy addressed the Canadian Parliament he said: "Geography has made us neighbors, history has made us friends, economics has made us partners, and necessity has made us allies." More recently, at a summit meeting with Prime Minister Mulroney in Quebec City, President Reagan said: "No relationship is more important to the United States than our relationship with Canada."

In that spirit the United States welcomed the historic initiative of Prime Minister Mulroney when he proposed a bilateral free trade agreement with the U.S. The administration received congressional approval to begin negotiations with Canada under the so-called "fast track" procedures.

While these trade negotiations represent an historic opportunity to free up large amounts of trade, it has to be remembered that we have difficult negotiations ahead of us and there is certainly no guarantee we will be successful. We are now moving into the much more difficult phase of the negotiations involving individual issues. Hard bargaining lies ahead.

So what would a successful FTA mean to U.S. and Canadian trade? You can get a good idea from the objectives that have been generally agreed to: *First,* all tariff and non-tariff barriers to trade in goods and services should be removed as soon as possible, but not later than the year 2000. *Second,* policies, practices, and procedures of governments should be trade neutral. *Third*, the FTA should be GATT-consistent and cover substantially all trade.

If these negotiations toward a free trade agreement are successful, we expect a substantially different trade and investment environment to emerge. We will see changes as early as 1988 and on through the year 2000, when the agreement will be fully operational.

We seek a fair agreement that is as broad and complete as possible, that offers both countries greater market access, opportunities for increased productivity, investment and employment, and enhanced international competitiveness. Such an arrangement would put our commercial dealings on a more sound footing and provide a clear signal to the rest of the world about our joint commitment to comprehensive trade liberalization. Our example would give strong impetus to the GATT Uruguay Round talks, in which the U.S. and Canada share similar goals.

The United States has six broad objectives in the FTA negotiations; first is the elimination of tariffs. Tariffs are still a significant barrier to trade on many products. We also aim to reduce the formalities and complications involved in cross-border commerce. Second is the reduction of non-tariff barriers maintained at both the federal and provincial levels. Examples are government procurement preferences, discriminatory liquor distribution systems, and technical agricultural barriers. Third is the development of rules to govern trade in services, such as trucking, insurance and computer services. fourth is the improvement of protection for intellectual property. Fifth is the achievement of greater discipline over subsidies.

Sixth is the achievement of an open and secure environment for foreign investment. While Canada now has a more open climate for foreign investment and is promoting foreign investment through Investment Canada, we seek protection of investor rights through a permanent agreement. Investors in *both* countries need long-term assurances that new barriers to trade and investment will not be erected. With a strong free trade agreement we expect significant increases in investment in both countries.

Canadian trade minister Pat Carney, in a recent speech, made a number of points in favour of a free trade agreement. She said a free trade agreement will provide a secure environment in which business thrives, lower costs and promote efficiency and enhance each country's international competitiveness. I would add that a successful free trade agreement will promote higher levels of economic growth in both Canada and the U.S., and contribute significantly to the strength of both countries.

The FTA's Relationship to the Uruguay Round

The United States is committed to the fight against protectionism multilaterally as well as bilaterally. The launching of the Uruguay Round at Punta del Este last September was an important victory for the United States and Canada, as well as for all nations endorsing a free and open international trading system. Ministers attending these talks succeeded in setting forth a bold, comprehensive agenda designed to address the inadequacies of the international trading system, and to ensure the future relevancy of the GATT as an institutional framework governing international trade relations. The Uruguay declaration provides a clear mandate for GATT members to address (1) those aspects of the present GATT system which may need strengthening or updating; and (2) those aspects of the international trading system which do not yet come within the purview of GATT rules.

Our highest priority is expanding GATT coverage to such areas as agriculture, services, intellectual property, and investment. This will be the most difficult challenge of the Uruguay Round negotiations.

I have heard the FTA described as a model for the Uruguay Round of multilateral trade negotiations; I prefer to view it as a much more ambitious example of trade liberalization between two close trading partners. If we are successful it will go well beyond what we can hope to accomplish in multilateral negotiations with about 100 nations, and should be a strong incentive for further multilateral liberalization.

The FTA will have to be consistent with the GATT, which is why auto trade will somehow have to be included. The GATT requires that a free trade area agreement cover substantially all trade. We are also endeavoring to assure that what we are doing in the FTA is consistent with our goals in the Uruguay Round. Canada and the United States share many common goals in the multilateral effort.

The Challenge

In closing, I would like to leave you with a few key thoughts. We are now moving into the most difficult phase of the FTA negotiations. It is clear to me that neither of our governments is going to sign an agreement that is not in our national interest. Our Congress will likewise not endorse an agreement that is not perceived to be in the national interest.

The challenge, as I see it, is for both countries to have the vision to be willing to change current barriers to trade and investment in order to secure long-term benefits of historical proportions. If we meet this challenge, we will have improved the economic environment in a way that will expand the creative output of our citizens.

Address: A Tale of Two Countries

Hugh MacLennan, Novelist

Seven and a half years ago I finished my last novel, *Voices of Time*, and knew it would be the last novel I would ever write. It occupied some 10 years of my life and it exhausted me. Becoming a great variety of characters can be a soul-bending experience. I realized that I had reached the stage when I must try to deal with the most inexplicable character I had any knowledge of, myself.

I was born in 1907, and it was only a few years ago that I discovered that this was the most fatal date in the entire twentieth century, because it was then that the First World War became inevitable. It came upon me just before my eightieth birthday, when I was invited to Princeton University to give the James Madison Address and to receive the James Madison Medal. As I had been dismissed from Princeton some 52 years ago as an irritating socialist and an incompetent scholar, this was a moving experience. Memories crowded me, and I shall share some of them with you now, if for no other reason than that the most perplexing problem in Canada's existence has always been her relationship with the United States.

When I first went to the United States in the fall of 1932 the world was in the bottom black hole of the Great Depression which began with the Wall St. crash in 1929. In that year I was in Oxford as a Rhodes Scholar working 12 hours a day to prepare for my examinations in Honours Moderations, very tough exams which searched every nook and corner of a student's ignorance. I did not know at the time that the market had crashed, but two years later I certainly discovered what this meant for anyone my age. In 1932, only three per cent of Rhodes Scholars leaving Oxford were able to step into jobs, and I was not one of the three per cent.

Anyway, I finished at Oxford, went home to my parents in Halifax, tried to get a job and failed, so my doctor-father proposed that I apply for entrance to the Princeton Graduate College.

On the train from Penn Station to Princeton Junction, I noticed that little smoke came out of the factory chimneys in New Jersey. I got a cab to the Graduate College and the town seemed beautiful and peaceful.

I was shown to my room in the Graduate College and found I was to share the bathroom with another Oxford man whom I had met briefly before. His name was Geoffrey Bing and thinking back on him, with some affection, I now realize that he was a portent of his time. He was marvellously witty. He looked almost Oriental, and with good reason for he later told me that his grandfather had been a Rhenish baron who had married a lady of the famous Hungarian family of Esterhazy, was later expelled from Germany, had emigrated to Indo-China where he made a small fortune furnishing white slaves to the troops of the French garrison.

Geoffrey himself had been born in Ireland. After a year in Princeton he became a communist, fought in the desert battles of the Hitler War, returned to England and befriended an African student called N'Kruma who became President, and immediately afterwards dictator of the old Gold Coast, the name of which he changed to G'hana. He made Geoffrey his attorney-general, then he went mad with megalomania, slept in a bed of solid gold and soon afterwards was murdered by an enraged population. Geoffrey escaped, surfaced later in London and was elected to Parliament where his lethal wit infuriated the Conservatives. He even became respectable toward the end, was made a Queen's Counsellor before he died a few years ago.

However, a gentleman far more celebrated than Geoffrey Bing arrived in Princeton during my first year and he was Albert Einstein. The previous year he had lectured at Oxford and physicists and mathematicians had assembled from all over the world to examine his last equations. At that time they were still arguing about Einstein's theories. Some scientists thought the universe was cylindrical; some thought it was finite; more cautious ones were willing to admit that they didn't know. A headline in a London paper displayed Einstein's picture and beneath it was the caption: "Will he tell us where we are?"

Einstein loved solitary walks and sometimes he lost his way because his thoughts were elsewhere. One chilly afternoon I went out for a run around the Christ Church Meadows, came around a sharp bend in the tow-path and crashed headlong into Einstein. I was aghast. But Einstein's marvellous eyes showed nothing but gentle curiosity. "Young man," he said, "can you tell me please vair am I?" Later on, in Princeton, he was to ask me the same question on two more occasions.

The title I offered in Princeton for the Madison Medal address was "A Tale of Two Countries", and I think it fits just as well at home as it did there. Never in history have two countries been more closely entwined than the United States and Canada. Never, so far as I know, has there been such a weird blending of chance and irony in the relations that grew up between these two countries.

As every Canadian knows, the first European navigator to strike North America above Florida was Jacques Cartier, and one may wonder what would have been the future on this continent if he had made his landfalls in Massachusetts or Virginia instead of Percé Labrador and the St. Lawrence estuary. As all Canadians know, he was stopped three times by the Lachine Rapids, but he did climb Mount Royal and saw the vast forests and the river itself curving westward on the far side. The last of his three voyages was made in 1536, and though on his return to France he wrote a description of them, nearly a century elapsed before another expedition was made to Canada from France.

Then came Champlain, first to Nova Scotia in 1605, three years later to the St. Lawrence, where he followed Cartier's route up the river and in the year of Milton's birth he founded the city of Quebec. Immediately the ironies began to form.

Champlain's king and patron was the great Henri IV, originally a Protestant who converted to Catholicism in order to terminate the religious wars that were tearing France apart. "*Paris*," he said in a famous sentence, "*vaut bien une messe.*" The Protestant Champlain followed suit because he knew he could never establish a colony in the midst of a religious war. Although a number of Champlain's team of explorers remained Protestants, there was at least no religious war in the colony.

The region now known as Quebec he called "New France", just as, a generation later, the first English colonists to the continent called their region "New England". But there was a vast difference of motive between the early French and the early English settlers. The English came for religious freedom; the French were lured on by the dream of the Northwest Passage to China. Champlain was the first European to discover that if men were to travel in the densely forested northern country they would have to forget about horses and even about European methods of navigation. Cartier had been stopped at the Lachine Rapids and so was he: "The water here is so swift," he wrote, "that it could not be more so. It is impossible to imagine any one's being able to go by boat through the falls. But anyone desiring to pass them should provide himself with the canoe of the savages, which a man can easily carry."

So began, in Champlain's first tentative journey above Montreal in a birch bark canoe, the first chapter in a long era of voyaging. For many years the barrier of the Appalachians was to hold up the later English settlers of the original 13 Colonies, but the situation was very different for the Canadians. It was long after the settlement that the French *voyageurs* in their canoes penetrated to the heart of North America. For two centuries, followed by Scottish Highlanders after the Conquest, the canoe parties threaded their way through the hinterland of North America, moving east to west and north to south. LaSalle, setting out to discover the Northwest Passage, followed previous voyages of Hennepin and Cadillac and went all the way down the Mississippi to the Gulf of Mexico. Soon afterwards LeMoyne de Bienville, who owned a seigneury across the river from Montreal, founded the city of New Orleans. Some of his descendants are living in Montreal today.

The supreme irony in the bizarre relationship between Canada and the United States came to pass in the mid-eighteenth century when William Pitt the Elder set out to demolish French rule in North America. Louisbourg fell, then Quebec in the famous battle on the Plains of Abraham in which Montcalm and Wolfe were both killed. All French possessions in North America except the tiny islands of St. Pierre and Miquelon were ceded to Great Britain by the most ruinous king in French history, Louis XV.

Then entered a new historical factor in the person of the young George III, who was even more disastrous to Britain than Louis XV had been to France. Every American knows what he tried to do to their ancestors and knows also what his ancestors did to him. But it was not the famous Boston Tea Party that ignited the Revolution, though it certainly prepared the way for it. It was the Quebec Act of 1774, designed to keep the conquered French quiet, also to give them some rights in the land their ancestors had discovered and explored.

The ironies continue. At the beginning of the American Revolution, a small American force occupied Montreal, and Benjamin Franklin came along with the first printing press ever seen in Canada. A British counter-attack sent him home in such a hurry that he left the printing press behind. It was used to print the newspaper which grew into the Montreal *Gazette*, second-oldest newspaper in the world still extant, and for two centuries one of the most conservative. Now, I'm sorry to say, it has become an over-sized tabloid.

The ironies continue, and the next ones were caused by Napoleon Bonaparte. The Louisiana Purchase was the first, whereby the United States, in the presidency of Jefferson, bought Louisiana for a song without knowing what Louisiana actually was. The French-

Canadians certainly knew what a good deal of it was. In the end, the United States gained from the purchase what became 12 new states besides Louisiana itself—in fact the whole area drained by the Mississippi and Missouri rivers together with their great tributaries. No wonder that some Americans thought their country the chosen of the Lord after a deal like that! No wonder that the French-Canadians whose forebears had explored so much of that vast region, thought there was no justice in the world and put their hopes in a Roman Catholic heaven.

Now for the supreme irony of all. Henry Clay and his war Hawks, abetted by some trickery on the part of Napoleon, brought about the absurd War of 1812 in which one of the ablest of American presidents soon found himself trapped. It was the year in which Napoleon made his fatal march on Moscow. As the only area in which American troops could attack Britain was a small corner of Upper Canada, they made an invasion. They burned a village called York, now become the huge city of Toronto. But immediately afterwards Napoleon was ruined in Russia, the British navy crossed the Atlantic and they did what they did in Washington. A month after the war had officially ended, Andrew Jackson crushed a British force at New Orleans and matters were left, apparently, where they were. But one thing the peace-makers did accomplish. Between them they established the Canadian-American border and it has endured ever since. Today, relations between Americans and Canadians living along that border are more cordial, by a good deal, than were relations between New Jersey and Pennsylvania when I was a student in the States.

Sometimes people ask, what is the difference between Canada and the United States apart from the climates? Historically and psychologically there are very great differences. Until the long *débacle* in Vietnam, the Americans had never lost a war against a foreign power. But the ancestors of nearly all Canadians were losers.

The French were losers in what many Americans called "The French and Indian Wars". Then it was the turn of the United Empire Loyalists who were forced to emigrate to Canada after the success of the Revolutionists. Next came the turn of the Highland Scotch who were expelled from their glens to enable their chiefs to support their incompetence by turning the glens into sheep runs. Next, in the late 1840s, came the desperate Irish from the Potato Famine. Does it signify anything that a descendant of one of these who emigrated to Ontario is now president of the United States, and that a descendant of another who emigrated to Quebec is now prime minister of Canada, though I doubt if either of them will remain much longer in that position. And finally, since the last World War, followed by the wars in Korea, Vietnam and the Middle East, millions of Europeans and

Asiatics, displaced persons, have come to Canada from all over the world.

To a veteran like myself, Canada seems suddenly to have become an entirely different sort of country. In 1940 the population of Toronto was pretty solidly of English, Scotch and Scotch-Irish extraction. Today these are far outnumbered by immigrants from Italy, Quebec, China and other Asiatic countries as well as many from the Middle East. Great numbers of Haitians have come to the province of Quebec. All this leads me to the conclusion I cannot avoid, and my early work at Princeton has drawn me to it.

In Princeton I wrote a thesis based on the Oxyrhynchus Papyri, an enormous collection of documents, written in Greek, and preserved in the arid sands of the Egyptian Thebaid. There the evidence of the decline and fall of the Roman Empire is spelled out in clear figures. The Roman empire ultimately collapsed because its currency collapsed. When Augustus died in A.D. 14 the denarius of the western empire and the drachma of the eastern empire contained four grams of silver. When Hadrian died in A.D. 137 there were two grams in both. But soon afterwards the coinage got into serious trouble. There was a century of virtual anarchy owing to vicious or incompetent emperors and above all there were small but costly civil wars. Christianity triumphed during this confusion, but the living spirit of Christ was hard to find among its bishops. The troops hired by the emperors were mostly barbarians and when their employers went broke they turned on them. Alaric, a barbarian who professed to be a Christian, sacked Rome in A.D 410. St. Jerome had just completed his monumental translation into Latin of the Bible when this happened, and St. Jerome recorded that when he heard this news it seemed as though the world itself had ceased to live.

I will now venture a bold statement that I believe is fundamentally true. Whatever may be the mystery we call God, I am sure he is not a racist. For 400 years the white and Christian races of Europe and America have felt themselves to be the elite of history, and in a sense they were. But this century through which I have lived has seen them virtually destroying themselves.

In the first German War, France was decimated. Britain, with nearly a million dead, was brought to the verge of bankruptcy. In the second installment, France collapsed in four days, Hitler lost his gamble in Russia after appalling casualties on both sides. In the worst crisis of the Hitler War, Japan suddenly struck and that really spilled the baby out with the bath water. Churchill immediately saw that this would finish off the British Empire, and so it did. But America, with the Marshall Plan and the very shrewd statesmanship of President Truman, rescued Europe and stabilized its frontiers with Russia. Then came Vietnam, which I have heard called "Harvard's

War", and apart from the social upheavals it caused among the youth of America and the entire world, it pretty well finished off the U.S. and Canadian dollars. Television has taken over the role of the old circus games in keeping the people quiet, but I must ask myself what ultimately can come of this.

When I was first in California – the year was 1939 – along the roads were signs reading "All the Orange Juice You Can Drink For Ten Cents." Yesterday in Montreal a single large orange cost me 85 cents. And to go to the humblest of foods – the hot dog. In 1939 you could get one for ten cents. Yesterday in Montreal I bought one for $1.35 – ten cents more than the same morsel cost me a month ago. Climatic differences makes it a little easier for Americans than for us, but the trillions they are pouring out on weapons they dare not use may make their economy even leakier than ours.

Now I would not predict that what happened to Rome is going to happen to us. We possess far more varied and sophisticated skills than the Romans ever dreamed of. Our economy could recover in a generation if there were the will and the intelligence. This was proved by America's achievement in rescuing Europe after the Hitler War.

However, of one thing there can be no doubt whatever – the rule of the so-called "White Man" is virtually over. We can see it very clearly here in Canada. Hard-working Asiatics, speaking more than two languages, are making small fortunes in small *dépaneurs* in Montreal and I would guess in most parts of the country. Intermarriage or at least interbreeding between native-born Canadians and Asiatic and black immigrants is going on a-pace. And the exploit that young Canadians most strongly applaud and identify with is that of Rick Hanson, the paraplegic who drove his wheel-chair all around the world and shortly is to marry the wonderful young woman who was his physiotherapist. I thank God that Rick comes from British Columbia – and for obvious reasons!

Members of the Institute

Board of Directors

The Honourable John B. Aird, O.C.,Q.C. (Honorary Chairman)
Aird & Berlis
Toronto
Roger Charbonneau, O.C. (Chairman)
Président du conseil d'administration
Banque Nationale de Paris (Canada)
Montréal
Rosalie Abella
Chairman, Ontario Labour Relations Board
Toronto
Dr. Robert Bandeen
President and Chief Executive Officer
Cluny Corporation
Toronto
Nan-Bowles de Gaspé Beaubien
Vice-présidente, ressources humaines
Télémédia Inc.
Montréal
Larry I. Bell
Chief Executive Officer
Vancouver City Savings Credit Union
Marie Bernier
Montreal
Catherine Callbeck
Central Bedeque, PEI
Allan F. Collins
Financial Advisor
Government of Alberta
Edmonton
Peter C. Dobell
Director, Parliamentary Centre for Foreign Affairs and Foreign Trade
Ottawa
Dr. Rod Dobell
President, The Institute for Research on Public Policy
Victoria
Peter C. Godsoe
Vice Chairman of the Board
The Bank of Nova Scotia
Toronto
Dianne I. Hall
Vancouver
David Hennigar
Atlantic Regional Director
Burns Fry Limited
Halifax
Roland J. Lutes, C.A.
Clarkson Gordon
Toronto
Dr. Tom Pepper
Pepper Consultants Ltd.
Saskatoon

Guy Roberge, C.R.
Conseil
Clarkson, Tétrault
Ottawa
Robert K. Siddall
Senior Vice-President & Secretary
The Great-West Life Assurance Co.
Winnipeg
The Honourable Robert L. Stanfield, P.C., Q.C.
Ottawa
Marc-Adélard Tremblay, O.C.
Département d'anthropologie
Universite Laval
Sainte-Foy

President
Rod Dobell

Vice-President and Secretary-Treasurer
Peter C. Dobell

Investment Committee
Peter C. Godsoe, Chairman
Robert Bandeen
Marcel Cazavan
Peter C. Dobell
Michael Koerner

Executive Committee
Dr. Roger Charbonneau, O.C.
(Chairman)
Dr. Robert Bandeen
Peter C. Dobell
Dr. Rod Dobell
Roland J. Lutes

Council of Trustees

Members at Large
Dr. Ronald L. Watts, O.C. (Chairman)
Department of Political Studies
Queen's University
Kingston
Doris H. Anderson, O.C.
Toronto
Marie-Andrée Bertrand
Ecole de criminologie
Universite de Montreal
Dr. Roger A. Blais, O.C.
Directeur, R-D coopératifs
École Polytechnique de Montréal
Jill Bodkin
Vancouver
George Cooper, Q.C.
McInnes, Cooper and Robertson
Halifax
James S. Cowan, Q.C.
Partner
Stewart, MacKeen & Covert
Halifax
V. Edward Daughney
President
First City Trust Company
Vancouver
Dr. H.E. Duckworth, O.C.
Chancellor
University of Manitoba
Winnipeg
Dr. Stefan Dupré, O.C.
Department of Political Science
University of Toronto
Marc Eliesen
Chairperson and Executive Director
Manitoba Energy Authority
Winnipeg
Emery Fanjoy
Secretary
Council of Maritime Premiers
Halifax
Maureen Farrow
C.D. Howe Institute
Toronto
Dr. James D. Fleck
Faculty of Management Studies
University of Toronto
Dr. Allan K. Gillmore
Executive Director
Association of Universities and Colleges of Canada
Ottawa
Dr. Donald Glendenning, C.M.
President, Holland College
Charlottetown
Margaret C. Harris
Past President, The National Council of Women of Canada
Saskatoon
Michael Hicks
Principal, Centre for Executive Development
Ottawa
Dr. David Hopper
Washington, D.C.

Richard W. Johnston
President
Spencer Stuart & Associates
Toronto
Dr. Leon Katz, O.C.
Saskatoon
Dr. David Leighton
Director, National Centre for Management Research and Development, University of Western Ontario
London
Terrence Mactaggart
Managing Director
Sound Linked Data Inc.
Mississauga
Judith Maxwell
Chairman
Economic Council of Canada
Vanier
Claude Morin
École nationale d'administration publique
Québec
Milan Nastich
Canadian General Investments Ltd.
Toronto
Professor William A. W. Neilson
Dean, Faculty of Law
University of Victoria
Roderick C. Nolan, P.Eng.
President
Neill & Gunter Limited
Fredericton
Robert J. Olivero
United Nations Secretariat
New York
Gordon F. Osbaldeston, O.C.
Senior Fellow, School of Business Administration, University of Western Ontario
London
Garnet T. Page, O.C.
Calgary
Jean-Guy Paquette
Recteur
Université Laval
Québec
Dr. K. George Pedersen
President
University of Western Ontario
London
Professor Marilyn L. Pilkington
Osgoode Hall Law School
Toronto
Dr. Stuart L. Smith
Chairman
Science Council of Canada
Ottawa
Eldon D. Thompson
President, Telesat
Vanier
Dr. Israel Unger
Dean of Science
University of New Brunswick
Fredericton
Dr. Norman Wagner
President and Vice-Chancellor
University of Calgary
Ida Wasacase, C.M.
Winnipeg
Dr. R. Sherman Weaver
Director
Alberta Environmental Centre
Vegreville
Dr. Blossom Wigdor
Director, Program in Gerontology
University of Toronto

Government Representatives

Roger Burke, Prince Edward Island
Herb Clarke, Newfoundland
Joseph H. Clarke, Nova Scotia
Lee Doney, British Columbia
Christian Dufour, Québec
Hershell Ezrin, Ontario
George Ford, Manitoba
Barry Mellon, Alberta
Geoffrey Norquay, Canada
Norman Riddell, Saskatchewan
Eloise Spitzer, Yukon
Barry Toole, New Brunswick
Gérard Veilleux, Canada
Louise Vertes, Northwest Territories

Institute Management

Rod Dobell	President
Peter Dobell	Vice-President and Secretary-Treasurer
Yvon Gasse	Director, Small & Medium-Sized Business Program
Barbara L. Hodgins	Director, Western Resources Program
John Langford	Director, Governability Research Program
Barry Lesser	Director, Information Society Studies Program
Shirley Seward	Director, Studies in Social Policy
Murray Smith	Director, International Economics Program
Jeffrey Holmes	Director, Communications
Parker Staples	Director, Financial Services
Tom Kent	Editor, *Policy Options Politiques*

Fellows- and Scholars-in-Residence:

Edgar Gallant	Fellow-in-Residence
Tom Kent	Fellow-in-Residence
Eric Kierans	Fellow-in-Residence
Jean-Luc Pepin	Fellow-in-Residence
Gordon Robertson	Fellow-in-Residence
Jim Cutt	Scholar-in-Residence
Alan Maslove	Scholar-in-Residence

Publications Available – August 1987

Order Address

The Institute for Research on Public Policy
P.O. Box 3670 South
Halifax, Nova Scotia
B3J 3K6

Leroy O. Stone & Claude Marceau	*Canadian Population Trends and Public Policy Through the 1980s.* 1977 $4.00
Raymond Breton	*The Canadian Condition: A Guide to Research in Public Policy.* 1977 $2.95
J.W. Rowley & W.T. Stanbury (eds.)	*Competition Policy in Canada: Stage II, Bill C-13.* 1978 $12.95
C.F. Smart & W.T. Stanbury (eds.)	*Studies on Crisis Management.* 1978 $9.95
W.T. Stanbury (ed.)	*Studies on Regulation in Canada.* 1978 $9.95
Michael Hudson	*Canada in the New Monetary Order: Borrow? Devalue? Restructure!* 1978 $6.95
David K. Foot (ed.)	*Public Employment and Compensation in Canada: Myths and Realities.* 1978 $10.95
Raymond Breton & Gail Grant Akian	*Urban Institutions and People of Indian Ancestry: Suggestions for Research.* 1979 $3.00
Thomas H. Atkinson	*Trends in Life Satisfaction Among Canadians, 1968-1977.* 1979 $3.00

W.E. Cundiff & Mado Reid (eds.)	*Issues in Canadian/U.S. Transborder Computer Data Flows.* 1979 $6.50
Meyer W. Bucovetsky (ed.)	*Studies in Public Employment and Compensation in Canada.* 1979 $14.95
Richard French & André Béliveau	*The RCMP and the Management of National Security.* 1979 $6.95
G. Bruce Doern & Allan M. Maslove (eds.)	*The Public Evaluation of Government Spending.* 1979 $10.95
Leroy O. Stone & Michael J. MacLean	*Future Income Prospects for Canada's Senior Citizens.* 1979 $7.95
Richard M. Bird	*The Growth of Public Employment in Canada.* 1979 $12.95
Richard J. Schultz	*Federalism and the Regulatory Process.* 1979 $1.50
Richard J. Schultz	*Le fédéralisme et le processus de réglementation.* 1979 $1.50
Elliot J. Feldman & Neil Nevitte (eds.)	*The Future of North America: Canada, the United States, and Quebec Nationalism.* 1979 $7.95
David R. Protheroe	*Imports and Politics: Trade Decision Making in Canada, 1968-1979.* 1980 $8.95
G. Bruce Doern	*Government Intervention in the Canadian Nuclear Industry.* 1980 $8.95
G. Bruce Doern & Robert W. Morrison (eds.)	*Canadian Nuclear Policies.* 1980 $14.95
Allan M. Maslove & Gene Swimmer	*Wage Controls in Canada: 1975-78: A Study of Public Decision Making.* 1980 $11.95
T. Gregory Kane	*Consumers and the Regulators: Intervention in the Federal Regulatory Process.* 1980 $10.95
Réjean Lachapelle & Jacques Henripin	*La situation démolinguistique au Canada: evolution passée et prospective.* 1980 $24.95
Albert Breton & Anthony Scott	*The Design of Federations.* 1980 $6.95
A.R. Bailey & D.G. Hull	*The Way Out: A More Revenue-Dependent Public Sector and How It Might Revitalize the Process of Governing.* 1980 $6.95
David R. Harvey	*Christmas Turkey or Prairie Vulture? An Economic Analysis of the Crow's Nest Pass Grain Rates.* 1980 $10.95
Donald G. Cartwright	*Official Language Populations in Canada: Patterns and Contacts.* 1980 $4.95
Richard M. Bird	*Taxing Corporations.* 1980 $6.95

Leroy O. Stone & Susan Fletcher	*A Profile of Canada's Older Population.* 1980 $7.95
Peter N. Nemetz (ed.)	*Resource Policy: International Perspectives.* 1980 $18.95
Keith A.J. Hay (ed.)	*Canadian Perspectives on Economic Relations With Japan.* 1980 $18.95
Dhiru Patel	*Dealing With Interracial Conflict: Policy Alternatives.* 1980 $5.95
Raymond Breton & Gail Grant	*La langue de travail au Québec : synthèse de la recherche sur la rencontre de deux langues.* 1981 $10.95
David M. Cameron (ed.)	*Regionalism and Supranationalism: Challenges and Alternatives to the Nation-State in Canada and Europe.* 1981 $9.95
Heather Menzies	*Women and the Chip: Case Studies of the Effects of Information on Employment in Canada.* 1981 $8.95
H.V. Kroeker (ed.)	*Sovereign People or Sovereign Governments.* 1981 $12.95
Peter Aucoin (ed.)	*The Politics and Management of Restraint in Government.* 1981 $17.95
Nicole S. Morgan	*Nowhere to Go? Possible Consequences of the Demographic Imbalance in Decision-Making Groups of the Federal Public Service.* 1981 $8.95
Nicole S. Morgan	*Où aller? Les conséquences prévisibles des déséquilibres démographiques chez les groupes de décision de la fonction publique fédérale.* 1981 $8.95
Raymond Breton, Jeffrey G. Reitz & Victor F. Valentine	*Les frontières culturelles et la cohésion du Canada.* 1981 $18.95
Peter N. Nemetz (ed.)	*Energy Crisis: Policy Response.* 1981 $10.95
James Gillies	*Where Business Fails.* 1981 $9.95
Allan Tupper & G. Bruce Doern (eds.)	*Public Corporations and Public Policy in Canada.* 1981 $16.95
Réjean Lachapelle & Jacques Henripin	*The Demolinguistic Situation in Canada: Past Trends and Future Prospects.* 1982 $24.95
Irving Brecher	*Canada's Competition Policy Revisited: Some New Thoughts on an Old Story.* 1982 $3.00
Ian McAllister	*Regional Development and the European Community: A Canadian Perspective.* 1982 $13.95
Donald J. Daly	*Canada in an Uncertain World Economic Environment.* 1982 $3.00

W.T. Stanbury & Fred Thompson	*Regulatory Reform in Canada.* 1982 $7.95
Robert J. Buchan, C. Christopher Johnston, T. Gregory Kane, Barry Lesser, Richard J. Schultz & W.T. Stanbury	*Telecommunications Regulation and the Constitution.* 1982 $18.95
Rodney de C. Grey	*United States Trade Policy Legislation: A Canadian View.* 1982 $7.95
John Quinn & Philip Slayton (eds.)	*Non-Tariff Barriers After the Tokyo Round.* 1982 $17.95
Stanley M. Beck & Ivan Bernier (eds.)	*Canada and the New Constitution: The Unfinished Agenda.* 2 vols. 1983 $10.95 (set)
R. Brian Woodrow & Kenneth B. Woodside (eds.)	*The Introduction of Pay-TV in Canada: Issues and Implications.* 1983 $14.95
E.P. Weeks & L. Mazany	*The Future of the Atlantic Fisheries.* 1983 $5.00
Douglas D. Purvis (ed.), assisted by Frances Chambers	*The Canadian Balance of Payments: Perspectives and Policy Issues.* 1983 $24.95
Roy A. Matthews	*Canada and the "Little Dragons": An Analysis of Economic Developments in Hong Kong, Taiwan, and South Korea and the Challenge/Opportunity They Present for Canadian Interests in the 1980s.* 1983 $11.95
Charles Pearson & Gerry Salembier	*Trade, Employment, and Adjustment.* 1983 $5.00
Steven Globerman	*Cultural Regulation in Canada.* 1983 $11.95
F.R. Flatters & R.G. Lipsey	*Common Ground for the Canadian Common Market.* 1983 $5.00
Frank Bunn, assisted by U. Domb, D. Huntley, H. Mills, H. Silverstein	*Oceans from Space: Towards the Management of Our Coastal Zones.* 1983 $5.00
C.D. Shearing & P.C. Stenning	*Private Security and Private Justice: The Challenge of the 80s.* 1983 $5.00
Jacob Finkelman & Shirley B. Goldenberg	*Collective Bargaining in the Public Service: The Federal Experience in Canada.* 2 vols. 1983 $29.95 (set)
Gail Grant	*The Concrete Reserve: Corporate Programs for Indians in the Urban Work Place.* 1983 $5.00
Owen Adams & Russell Wilkins	*Healthfulness of Life.* 1983 $8.00
Yoshi Tsurumi with Rebecca R. Tsurumi	*Sogoshosha: Engines of Export-Based Growth.* (Revised Edition). 1984 $10.95

Raymond Breton & Gail Grant (eds.)	*The Dynamics of Government Programs for Urban Indians in the Prairie Provinces.* 1984 $19.95
Frank Stone	*Canada, The GATT and the International Trade System.* 1984 $15.00
Pierre Sauvé	*Private Bank Lending and Developing-Country Debt.* 1984 $10.00
Mark Thompson & Gene Swimmer	*Conflict or Compromise: The Future of Public Sector Industrial Relations.* 1984 $15.00
Samuel Wex	*Instead of FIRA: Autonomy for Canadian Subsidiaries?* 1984 $8.00
R.J. Wonnacott	*Selected New Developments in International Trade Theory.* 1984 $7.00
R.J. Wonnacott	*Aggressive US Reciprocity Evaluated with a New Analytical Approach to Trade Conflicts.* 1984 $8.00
Richard W. Wright	*Japanese Business in Canada: The Elusive Alliance.* 1984 $12.00
Paul K. Gorecki & W.T. Stanbury	*The Objectives of Canadian Competition Policy, 1888-1983.* 1984 $15.00
Michael Hart	*Some Thoughts on Canada-United States Sectoral Free Trade.* 1985 $7.00
J. Peter Meekison Roy J. Romanow & William D. Moull	*Origins and Meaning of Section 92A: The 1982 Constitutional Amendment on Resources.* 1985 $10.00
Conference Papers	*Canada and International Trade. Volume One: Major Issues of Canadian Trade Policy. Volume Two: Canada and the Pacific Rim.* 1985 $25.00 (set)
A.E. Safarian	*Foreign Direct Investment: A Survey of Canadian Research.* 1985 $8.00
Joseph R. D'Cruz & James D. Fleck	*Canada Can Compete! Strategic Management of the Canadian Industrial Portfolio.* 1985 $18.00
Barry Lesser & Louis Vagianos	*Computer Communications and the Mass Market in Canada.* 1985 $10.00
W.R. Hines	*Trade Policy Making in Canada: Are We Doing it Right?* 1985 $10.00
Bertrand Nadeau	*Britain's Entry into the European Economic Community and its Effect on Canada's Agricultural Exports.* 1985 $10.00
Paul B. Huber	*Promoting Timber Cropping: Policies Toward Non-Industrial Forest Owners in New Brunswick.* 1985 $10.00
Gordon Robertson	*Northern Provinces: A Mistaken Goal.* 1985 $8.00

Petr Hanel	*La technologie et les exportations canadiennes du matériel pour la filière bois-papier.* 1985 $20.00
Russel M. Wills, Steven Globerman & Peter J. Booth	*Software Policies for Growth and Export.* 1986 $15.00
Marc Malone	*Une place pour le Québec au Canada.* 1986 $20.00
A. R. Dobell & S. H. Mansbridge	*The Social Policy Process in Canada.* 1986 $8.00
William D. Shipman (ed.)	*Trade and Investment Across the Northeast Boundary: Quebec, the Atlantic Provinces, and New England.* 1986 $20.00
Nicole Morgan	*Implosion: An Analysis of the Growth of the Federal Public Service in Canada (1945-1985).* 1986 $20.00
Nicole Morgan	*Implosion: analyse de la croissance de la Fonction publique fédérale canadienne (1945-1985).* 1986 $20.00
William A.W. Neilson & Chad Gaffield (eds.)	*Universities in Crisis: A Mediaeval Institution in the Twenty-first Century.* 1986 $20.00
Fred Wien	*Rebuilding the Economic Base of Indian Communities: The Micmac in Nova Scotia.* 1986 $20.00
D.M. Daly & D.C. MacCharles	*Canadian Manufactured Exports: Constraints and Opportunities.* 1986 $20.00
Gerald d'Amboise, Yvon Gasse & Rob Dainow	*The Smaller, Independent Manufacturer: 12 Quebec Case Studies.* 1986 $20.00
David J. Roy & Maurice A.M. de Wachter	*The Life Technologies and Public Policy.* 1986 $20.00
David Feeny, Gordon Guyatt & Peter Tugwell (eds.)	*Health Care Technology: Effectiveness, Efficiency, and Public Policy.* 1986 $20.00
International Symposium	*Les repercussions de l'informatisation en milieu de travail / The Impact of New Information Technologies on the Workplace.* 1986 $20.00
N.G. Papadopoulos	*Canada and the European Community: An Uncomfortable Partnership?* 1986 $15.00
W.T. Stanbury (ed.)	*Telecommunications Policy and Regulation: The Impact of Competition and Technological Change.* 1986 $22.00
James Gillies	*Facing Reality: Consultation, Consensus and Making Economic Policy for the 21st Century.* 1986 $15.95
International Seminar	*The Management of Water Resources – Proceedings La gestion des ressources en eau – Actes.* 1986 $20.00

William J. Coffey & Mario Polèse (eds.)	*Still Living Together: Recent Trends and Future Directions in Canadian Regional Development.* 1987 $25.00
Bryan Schwartz	*First Principles, Second Thoughts: Aboriginal Peoples, Constitutional Reform and Canadian Statecraft.* 1987 $25.00
G.E. Salembier, Andrew R. Moroz and Frank Stone	*The Canadian Import File: Trade, Protection and Adjustment.* 1987 $20.00
Emer Killean	*Equality in the Economy: A Synthesis of the Proceedings of a Workshop / L'égalitarisme et l'économie : synthèse des débats d'atelier.* 1987 $10.00
John W. Langford (ed.)	*Fear and Ferment: Public Sector Mangement Today.* 1987 $14.50
Barry Lesser & Pamela Hall	*Telecommunications Services and Regional Development: The Case of Atlantic Canada.* 1987 $20.00
Stephen Brooks	*Who's in Charge? The Mixed Ownership Corporation in Canada.* 1987 $20.00
Richard W. Wright with Susan Huggett	*A Yen for Profit: Canadian Financial Institutions in Japan.* 1987 $15.00
Thomas Gunton and John Richards (eds.)	*Resource Rents and Public Policy in Western Canada.* 1987 $20.00
Shirley B. Seward and Mario Iacobacci (eds.)	*Approaches to Income Security Reform.* 1987 $10.00
Louis Raymond	*Validité des systèmes d'information dans les PME: analyse et perspectives.* 1987 20,00 $
A.R. Riggs & Tom Velk (eds.)	*Canadian-American Free Trade: Historical, Political and Economic Dimensions.* 1987 $15.00

The Institute for Research on Public Policy
L'Institut de recherches politiques

A national, independent, research organization
Un organisme de recherche national et indépendant

Créé en 1972, l'Institut de recherches politiques est un organisme national dont l'indépendance et l'autonomie sont assurés grâce à des revenus provenant d'un fonds de dotation auquel souscrivent les gouvernements fédéral et provinciaux ainsi que le secteur privé. L'Institut obtient en outre des subventions et des contrats des gouvernements, des compagnies et des fondations afin de réaliser certains projets de recherche.

La raison d'être de l'Institut est triple :

- Servir de catalyseur au sein de la collectivité nationale en favorisant un débat public éclairé sur les principales questions d'intérêt général.
- Stimuler la participation de tous les éléments de la collectivité nationale à l'élaboration de la politique d'État.
- Trouver des solutions réalisables aux importants problèmes d'ordre politique afin de contribuer à l'élaboration d'une saine politique d'État.

Un Conseil d'administration, chargé de la décision, et une Commission de direction, responsable d'éclairer le Conseil sur l'orientation de la recherche, assurent la direction de l'Institut. L'administration courante des politiques, des programmes et du personnel relève du président.

L'Institut fonctionne de manière décentralisée et retient les services de chercheurs en divers points du Canada, s'assurant ainsi que toutes les régions contribuent aux recherches.

L'Institut cherche à favoriser, dans la mesure du possible, la compréhension et la discussion publiques des questions d'envergure nationale, controversées ou non. Il publie les conclusions de ses recherches avec clarté et impartialité. Les recommandations ou les conclusions énoncées dans les publications de l'Institut sont strictement celles de l'auteur et n'engagent aucunement le conseil d'administration, la commission de direction ou les bailleurs de fonds.

Le président assume la responsabilité ultime de publier un manuscrit au nom de l'Institut. Il jouit à cette fin des conseils du personnel de l'Institut et de critiques de l'extérieur quant à l'exactitude et l'objectivité du texte. Ne sont publiés que les textes qui traitent de façon compétente d'un sujet digne de la réflexion du public.

Les publications de l'Institut paraissent dans la langue de l'auteur et sont accompagnées d'un abrégé dans les langues officielles du Canada.

Canadian-American Free Trade:
Historical, Political and Economic Dimensions

Edited by A.R. Riggs and Tom Velk

These papers presented at a conference in Montreal in mid-March 1987 examine the main policy issues in the negotiations for Canadian-American free trade, at a critical stage in these negotiations. The contributors include historians, economists, business leaders, government officials and trade policy specialists from both sides of the border:

Paul Stevens
Tom Velk
A.R. Riggs
Earl Fry
P. Soldatos
Richard Lipsey
Irving Brecher
Thomas d'Aquino
André Raynauld
Randall Wigle
Robert Young
Tim Hazledine
Benoit-M. Papillon
E.P. Neufeld
Donald Armstrong
Peyton Lyon
Frank Stone
Jacques Parizeau
Ambassador Thomas Niles
The Honourable Robert Layton, M.P.
Louis F. Laun
Hugh MacLennan

ISBN 0-88645-055-1 $15.00

The Institute for Research on Public Policy
L'Institut de recherches politiques
A national, independent, research organization
Un organisme de recherche national et indépendant